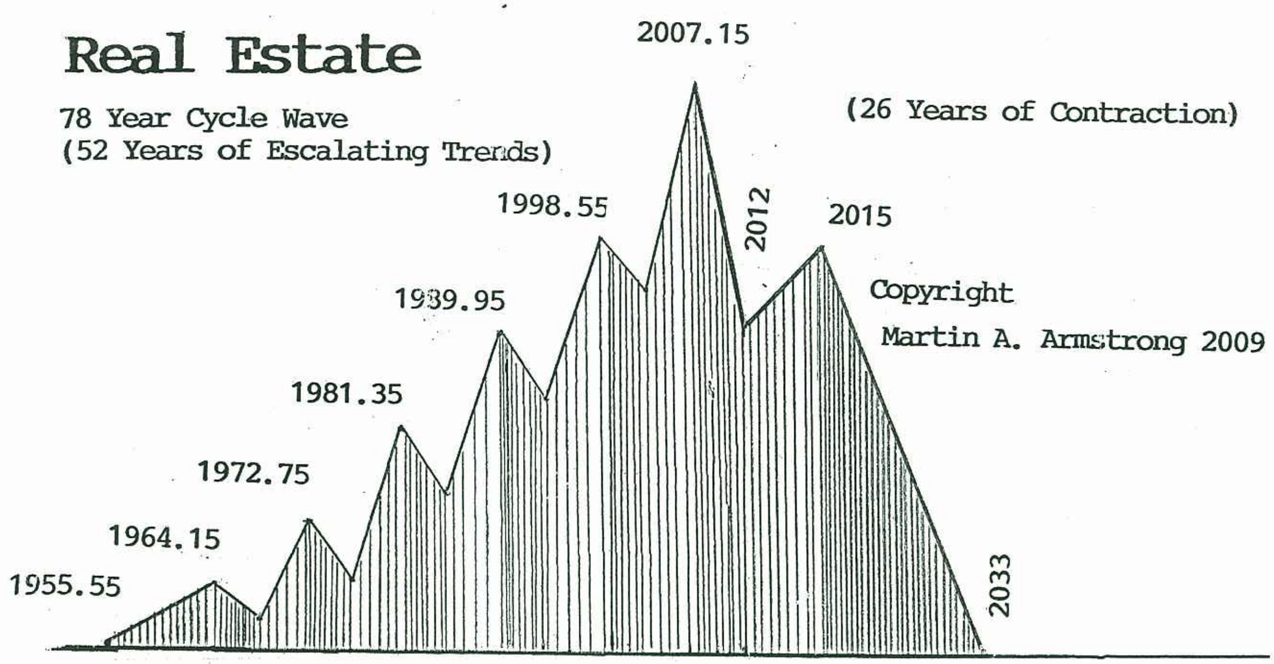
Armstrong Economics™

A Forecast for Real Estate



Martin A. Armstrong
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 November 15th, 2009

Comments Welcome: ArmstrongEconomics@GMail.COM (Internationally)

ACKNOWLEDGEMENTS

I would like to thank the many people who have been writing from around the world. It is encouraging to know that there are so many people who are interested in uncovering the truth. I have also special thanks for so many providing valuable insight into trends around the world from China, Soviet Republics, South Africa, Brazil, Australian, and India. I believe we can survive the folly of governments even if they refuse to listen. The key is understanding the nature of events, and that allows us to correctly make the decision to be on the opposite side.

I would like to also thank all my old friend and former clients for their support and to know that they have continued to gather information that serves us all in times of crisis.

We are standing on the precipice of a new era in global-social-economics. How we enter this new age is of critical importance. Government is incapable to doing anything for any reform of its own abuse of power is not up for negotiation. We must weather the storm, and to do so we need to understand its nature. Just as the 1930s Great Depression set in motion profound changes that were even manifest in geopolitical confrontations, we have now reached such a crossroads. A debt crisis has its tentacles deeply embedded into every sector right into government. This is the distinction from a mere stock market crash that never alters the economy long-term. We are seriously still over-leveraged and some banks are still trying to be hedge funds and have to speculate to make a profit. That is a key warning sign that the worse is yet to come.

Comments, Suggestions & Questions

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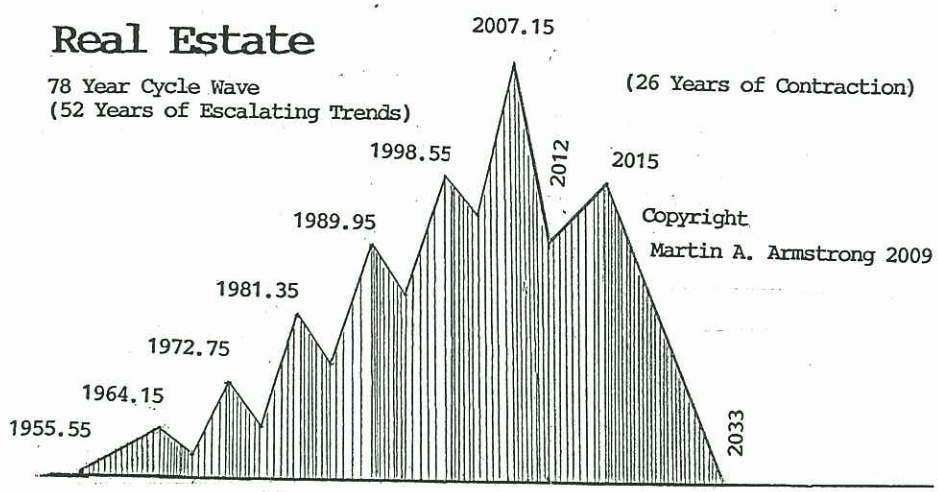
At a future date, a new edition of the 1986 The Greatest Bull Market In History will be released and a new book will soon be published on the model itself - The Geometry of Time. It is vital that we do not forget this is a world economy and the arrogance that any nation can dictate to the world is just insanity. Every nation effects all others no different than if one nation were to pour all its toxic waste into the ocean. Everything is interlinked and solutions are never isolated events.

A Forecast for Real Estate



By: Martin A. Armstrong

Former Chairman of Princeton Economics International, Ltd
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A **uspicium melioris aevi** is a phrase the Romans had when trying to look into the eyes of the future to capture a glimpse of what might be. The priest would proclaim this phrase that meant **"an omen of a better age."** When it comes to understanding what we face, it truly requires understanding of the **cyclical nature** of all things. For you see, the ancient beliefs had some advantage. They comprehended that nothing was ever constant. When Rome would be at war, the Temple of Janus had two doors that were left open to symbolize that there could be profound change. Thus, the two faced god whom January is named after and whose feast we still celebrate on New Year's Eve as we say hello to the **New Year** and good bye to the past, was indeed a feast of cycles. The Romans had yet another phrase that is remembered today - **Panta Rehi (all things are in flux)**. These, among many others, were a recognition that life is **not** linear and we truly stand at the threshold of our posterity. We can embrace it and learn to adopt with gathering knowledge from our mistakes to enable us to confront destiny with the knowledge of experience. We must visualize the flow of TIME to see a future.

There is no delicate way to put this right now, but we are looking at a serious economic depression in terms of values of real estate. We have reached a crossroad that is very profound and if we do **not** at least try to comprehend the problem, we may be facing the worst economic implosion that has taken place in centuries. Thanks to the New York Investment Banks, they helped to leverage real estate far beyond anything that took place in history, and we are going to pay the price.

I have been reluctant to discuss this subject matter because the readership is now quite broad. I have wrestled with this problem and concluded that it is not a subject that can be avoided. For you see, the 2007 target was one that had special significance. It was the target I would warn major clients could be one of those shock-waves that could truly reshape the world as we knew it. This is also the reason why I began to write again due to the profound seriousness of this major target **2007.15**. This is the convergence of **TIME** and **VOLATILITY** in none other than **REAL ESTATE!**

In many ways, we are so naive about our world and how it functions. There are a lot of charlatans out there who pretend to be able to analyze the trends to reach a view of the future. Many are dangerous and contribute to the overall inability to comprehend what is happening. They pull out a chart of the old stock market and pronounce the existence of a depression simply because the market fell sharply. It is not their fault. They believe often what they pronounce. But they lack the full understanding of how the economy even functions to arrive at a coherent complete structure through which the truly complex interaction of interrelationships manifests through a symphony of a constant state of flux.

They pull out the charts from the Great Depression and proclaim we are headed toward a collapse into deflation. They do not come close to understanding complexity. They fail to comprehend that **everything** is in motion. In the 1930s, the US was the creditor and it was Europe that was collapsing in debt unable to comprehend what they had done. As capital shifted from Europe to America, the twilight of the European Age had arrived. The capital flows shifted to America and by Bretton Woods in 1944, the US held 76% of the entire world gold reserves. Is it any wonder why the dollar became the reserve currency of the world?

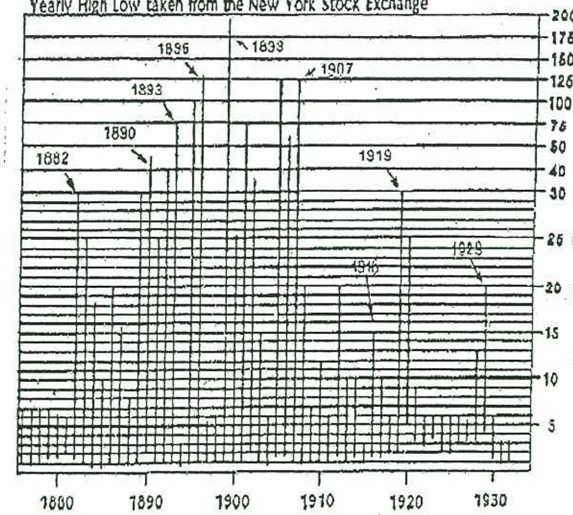
Absolutely everything you see around us is in fact in a constant state of movement. Interrelationships constantly change to the point that what once was up, is now down. There are different speeds within the whole cyclical movement and the **shock wave** unfolds when diverse aspects of cyclical movement now converge.

If we just look at the chart on call money rates, you will see that the high is during the minor panic of 1899. Even the 1907 Panic produced higher rates of interest than the Great Depression high of 1929. When I was young and began to try to figure out how this world ticked, it became clear if you just took each event and wrote down all the variables and compared them, what you quickly notice, there is no formula that you can create that states **If Interest Rates** = x% **THEN stock price = -30%**. It just does not work that way.

Everything is truly in a constant state of flux and this is why I have determined that **capital** concentrates on a revolving

CALL MONEY RATES 1876-1932

Yearly High Low taken from the New York Stock Exchange



basis. **Absolutely Everything is constantly moving.** What unfolds is an array of possibilities that are driven by a comlexity of such dynamic interaction. We are being prevented from advancing to the next level in mankind's journey through existence, because we have perhaps well meaning charlatans who try to reduce this complexity to a single and plain cause and effect. **The Dow rose today because the Fed cut rates!** This is just gibberish that prevents us from evolving to the next level of understanding.

PRESUME NOTHING

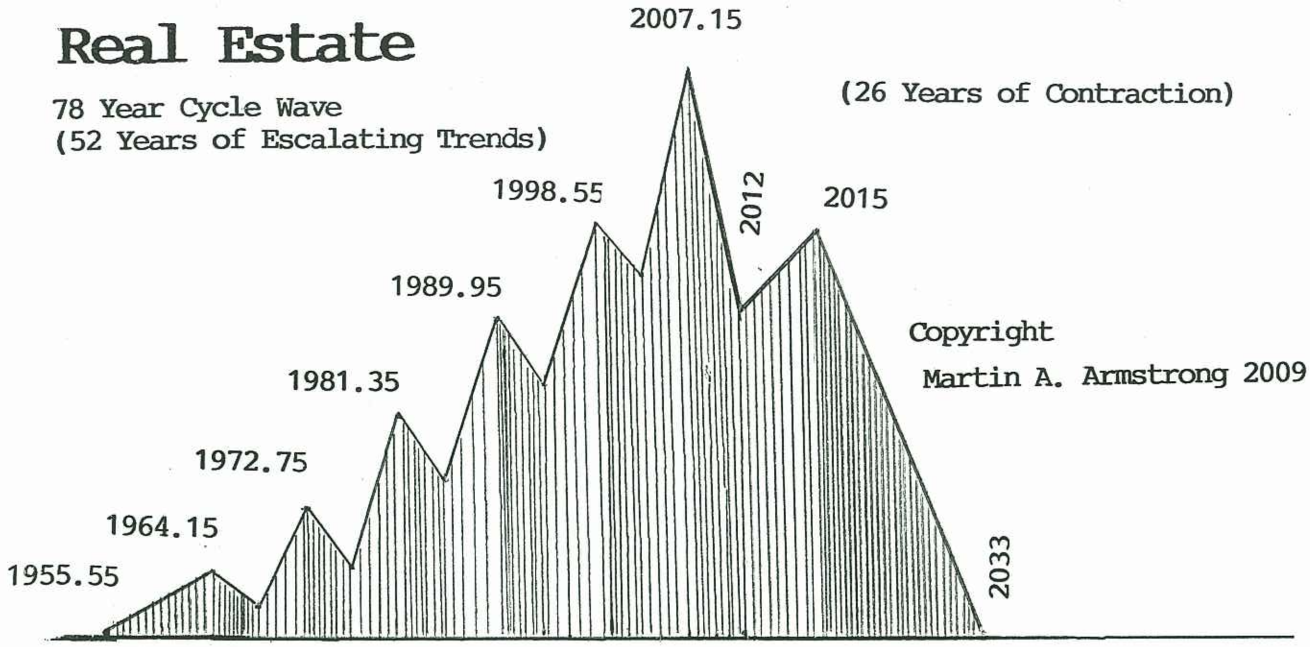
The **FIRST** golden rule, "Presume Nothing," is so profound, far too many people just go charging forward. It has been the **presumption** since my childhood, that real estate always rises in the **long-term** and thus is a great asset constituting the majority of the average person's wealth.

What if that Presumption is wrong?

Now we are entering into a subject-matter that is so fundamental, it starts to get a bit scary. You will now see what I have been very concerned about after discovering this serious problem decades ago.

I have written about the **Debt Crisis** that was faced in Athens by **Solon (630-530BC)** and **Julius Caesar (100-44BC)**. Now these history lessons will start to pay-off. What was it causing the debt crisis? **Real Estate!** This is critical to understand. It was not the public debt alone, but the private debt involving **REAL ESTATE!**

Real Estate



REAL ESTATE is above all other markets, the largest asset class. Where the STOCK MARKET, GOLD, COMMODITIES, and even BONDS are interesting investments, they are by far, still the minority insofar as participants. There is just no market that draws to itself more people than real estate. It is this key cycle in **Real Estate** that truly effects the sustainable length of profound economic depressions. This cycle breaks down as a **harmonic** or a **derivative** of the **Economic Confidence Model (ECM)**. It is composed of a broader period of time with a duration in total of 78 years (6 x 13). When this cycle turns down, it is a profound event for it effects the entire population on a wide scale. The decline from the major high consists of a period duration of **26 years**. This leaves us with a wave of generally rising prices (through short-term recessionary periods) of roughly 52 years (51.6 years to be precise). In other words, we are dealing with the **ECM** that has been extended through a longer contraction phase of 26 years that combines into a major wave of 78 years.

We would bring this model out for the heavy hitters where Princeon Economics created a **"natural hedge"** strategy for international portfolios. Taking the mix of investments globally, we then placed it into the computer correlating the whole picture. We then would advise what assets should be sold in what countries and where assets should be added balancing off the currency risk against each other **"naturally"** and where slippage existed, that is all that needed to be managed in the markets. Thus, we could take a $100 billion portfolio and now reduce the actual required hedging to a small fraction using a **"natural hedge"** to protect the bulk of the portfolio. To do that, we needed models on everything in every currency. Thus, what I am now showing for the first time publicly, is that general **Real Estate** model.

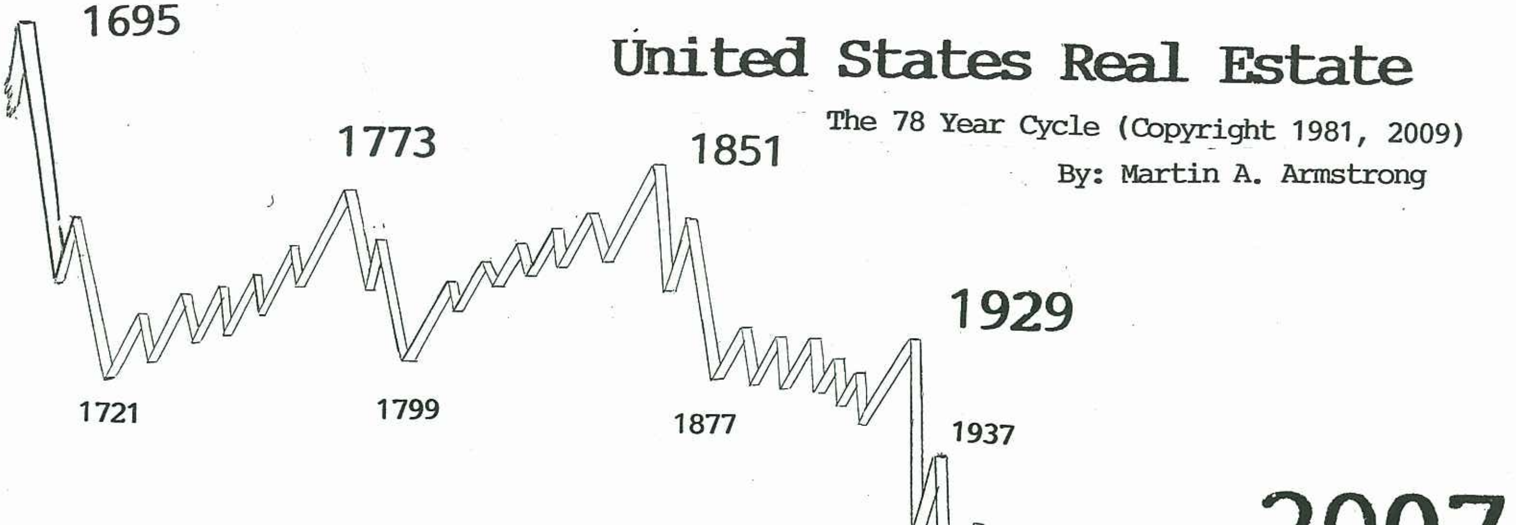
In order to deal with portfolios that included hotel chains and chains of pubs, it was vital that we also understood the risks associated with real estate. Not all things could be hedged using markets and real estate was certainly one of them. What I am about to reveal here, is the overall prime structure of real estate that was developed from studies we conducted in Europe, Japan, Australia, the USA as well as Canada.

Take Japan, for example. The peak was in 1989 when Tokyo was claimed to be worth the sum of all real estate in the USA. Go back 78 years and you hit 1911, the peak in the only independent emperor Meiji (1868-1912) and his death changed a lot. The emperor was once more subordinate to a shogun now in the form of a national military super-power that matured into World War II. The collapse in Tokyo real estate came 13 years later with the major earth quake and tidal wave combination that wiped out the city.

United States Real Estate

The 78 Year Cycle (Copyright 1981, 2009)

By: Martin A. Armstrong



Real Estate has been a separate asset class for centuries. There is a strange calling that inspires the desire to own property. Perhaps this extends back to the Dark Ages and being just surfs with a dream of becoming a landloard. Who knows where it begins, for we see the same human interaction back in Greece and Rome. Of course, it was the **Villa Model** that existed in ancient times that was both the symbol of wealth, and the self-independence that was a cherished liberty. The **Villa Model** was a self- sufficient estate that became a safe haven from taxation in Rome giving rise to the term **"suburbanization"**(flight from taxes cities). It was **Xenophon (431-353BC)** who wrote a book on how to manange you estate, wife & slaves he entitled **Okinomikos** (how to regulate the household) that gave birth to the term **"economics"** when translated by Francis Hutcheson (teacher of Adam Smith).

Debt and property extends back to ancient times. It is when the value of such property collapses, that what we end up with are the truly major economic disasters in history. These are the types of economic collapse that are just off-the-charts.

The value of land was rising during the late 1600s. It was considered to be the very essence of all wealth. In South Carolina, the prejudice against the French was great at that time and to deal with these foreigners fleeing France known as the **Huguenots,** the laws that were enacted prohibited that the land owned could even be inherited. It was forfeit upon death in 1693. The value of land came under pressure after 1695 because of the increase in the supply by the expansion westward. The City of Detroit was found by Antoine de la Mothe Cadillac on July 24th, 1701.

Between 1695 and 1721, this was the age of great expansion within the new land called America. Going into the peak for 1695, there was what one would call the first phase of expansion. This culminated in the **Salem Witch Trials** in 1692 under the Puritans that actually began to create a migration away from the insane religious right-wingers. For they executed 20 people on this nonsense, and that prompted migrations that led to the founding of Rhode Island. The year 1695, marked the laying of the foundation stone down in Virginia that began a new construction age. It was 1699 that the French began settlement in Mississippi and Louisiana. While expansion was unfolding, prices were stagnant to declining. This economic pressure burst through in a slave revolt in 1712 in New York on April 6th resulting in 21 slaves being executed. However, the speculation that unfolded on unrealistic expectations manifested in the 1720 **South Sea** and **Mississippi Bubbles.** The 26 year cycle was now completed.

1721-1773

The 26 year decline that had manifested from the high 1695, culminated with the big speculative bubbles in the **South Seas** and the **Mississippi Bubble** in France in 1720. With the speculation now squeezed out, we find a rebirth in attitude that I BELIEVE we may see in our immediate future.

In 1726, there was a riot of the poor in Philadelphia. But there was also the **Great Awakening** that was a religious revival that began in the American colonies. It led to new thinking and considering ideas that were largely forbidden by the strict Puritans. Eventually, a second **Awakening** began in New England at the bottom of this wave in 1799. So what we see is a change in religion that tends to also emerge at a time of economic stress, i.e. Constantine and Christianity following the great 3rd century collapse.

This is the cycle wave of the **Great Enlightenment** and in 1732 we find Benjamin Franklin (1706-1790) enters the scene with the publication of **Poor Richard's Almanack,** which he published until 1757. By 1754, it was Benjamin Franklin who had devised the first plan of union among the colonies, and there was a conference held in Albany, NY, on July 19th, 1754 among 7 colonies to now consider the union.

The conflict between Britain and France was long running. In 1709 there was the **Queen Anne's War (1701-13)** where the Brits captured Nova Scotia that was yielded in the treaty of 1713. Then there was **King George's War** (1744) pitting the colonials of both these nations in America against each other. Then there was the **French & Indian War** (1754-1763) that ended with the French losing Canada.

These three wars with durations of 13, 4.3, and 8.6 years, had their impact upon local real estate values suppressing them whenever there is war. But the impact that set in motion perhaps the entire revolution was the beginning of taxation on March 22nd 1765 with the enactment of the **Stamp Act.** While repealed in 1766, it reflected the rising resentment that the European conflict between Britain and France was causing an economic consequence in America.

The American Colonial economy was in fact growing. Land values were rising for the majority of this 52 year wave. This booming economy was also being met by a rise in demand for taxation. The British enacted the **Quartering Act** in 1765 requiring colonists to house British troops in their homes. In 1767, the **Townshend Acts** were imposed that had levied taxes on painter's lead, glass, and paper as well as tea. This in effect was taking notice of a housing boom that obviously required glass for windows and paint. These taxes were repealed as well as resistance rose, for here also, we find the taxes created a decline in the building boom. While the taxes were repealed in 1770, they remained in full force on tea.

The taxation demands were becoming very unpopular. We find the first show of violence taking place in Boston on March 5th, 1770 known as the **Boston Massacre.** Of course, the number killed was only 5. Still, this event of British soldiers firing upon colonists was used by the separatists to further their agenda. Eventually, we then have the tax protest manifest in the **Boston Tea Party** on December 16th, 1773. This provides the peak to this cycle and we now begin a 26 year decline, for what takes place here, is the American Revolution during which prices did only one thing - decline.

While one might expect real estate to rise in value once the war is over, there has always been a lagging period primarily due to the shortage of capital, **inter alia.** The problem is merely enhanced by the fact that the United States had also gone through a period of hyper-inflation as did Germany in the early 1920s following World War I.

Winning the war was half the battle. A crisis in currency also appeared for there had been a flood of continental dollars. It is this period of a economic crisis where one currency is collapsing and another is emerging.

The greatest problem is how to deal with **pre-existing debts**? This is precisely the very same problem faced by **Julius Caesar** after the civil war. Indeed, we find this economic turmoil unfold in 1787, two years before the birth of the United States in 1789. This is the **Shay's Rebellion** that is a riot concerning debt-ridden farmers in Mass.

Daniel Shays (1747-1825) was an officer during the American Revolution. He responded to the call to arms at Lexington in April of 1775 serving 11 days. He later joined and served at the Battle of Bunker Hill, went on the expedition against Ticonderoga, and he served in storming Stony Point and fought at Saratoga. He resigned from the Army in 1780 and settled in Pelham, Mass.

As with all wars, there is a very short and brief explosion of joy that will become manifest in economic activity. This was very pronounced in the Colonies going into 1783 for it was 1782 that Britain formally recognized the new country. But this bear market rally was followed by a swift resumption of a deep economic depression as everything has to now readjust.

There began a major wave of forclosures that was hitting the farmers (landholders). They were losing everything through seizures for overdue debts and delinquent taxes for you see, the states went after the people to get their's as they see it. Never has there been any respect for the people from those in power. These farmers were now even put into a version of contempt of court and left to die known as **debtor's prison.**

Shay's Rebellion took place August 1786 and lasted through February 1787. This became a uprising in western Massachusetts that had been sparked by rising taxation in the face of declining land values and debts. Farmers were having their property seized by the courts and one could be thrown into contempt effectively until you died. The people were banding together and Shays emerged as one of the leaders against this economic tyranny. This rebellion moved against the corruption in the courts and forced their closure to prevent the execution of these foreclosures and debt processes that could end up taking one's life over the claims of "inherent" power to just imprison citizens.

Shays led several hundred men that now forced even the closure of the Supreme Court in Springfield illustrating the resentment toward the judges that was building. Finally, in January 1787, Shays led a force now of 1,200 men to attack the federal arsenal in Springfield. This attack was repelled and the retaliation was swift. Shays would become a man of the people who should never be forgotten.

The militia was called out and now they pursued Shays' army. A battle emerged and on February 4th, 1787, **Shays' Rebellion** was thus defeated by overwhelming force at Petersham causing them to flee to Vermont. When it was over, the Supreme Court of Massachusetts in fact showed its ruthlessness toward the people and upheld condemning Shays and about a dozen others to death. Despite the loss, the State of Massachusetts was forced by Shays to now enact new laws easing the economic condition of debtors.

Shays was never captured. He had fled to Vermont and later moved to Schoharie county, New York. Several years later, he moved to Sparta, New York, where he died living on his federal pension for his contribution to the American Revolution. In 1788, Shays was in fact pardoned by the Governor of Massachusetts for he remained a folk hero and man of the real people.

This **Debt Crisis** was truly profound and as the model declined into 1799, there was a cascade of debt reforms. Even three judges from the Supreme Court of Pennsylvania were impeached and kicked off the court for then throwing a man in contempt with no trial. The rise against judges was truly profound. In fact, Congress had to outlaw **Debtor's Prison** in the Act of 1800, §5, establishing that if the debtor took an oath stating he had no money, he had to be released in 30 days, see <u>Pres, Dirs & Co of Bank of US v Weisiger</u>, 27 US 331 (1829). Despite this law, judges had continued to imprison citizens claiming that it was "contempt" of court. Chief Justice Marshall of the US Supreme Court declared:

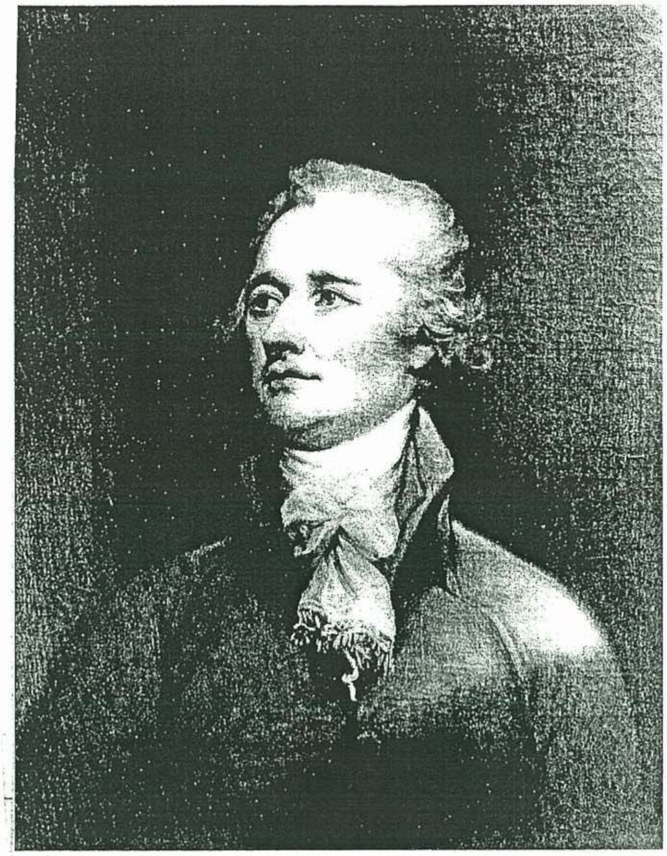
> "To punish honest insolvency, by imprisonment for life, and to make this a constitutional principle, would be an excess of inhumanity, which will not readily be imputed to the illustrious patriots who framed our constitution, nor to the people who adopted it."

<u>Sturges v Crowninshield</u>, 17 US 122, 200 (1819)

This is the backdrop to why Thomas Jefferson proclaimed that it would be the Judiciary that would destroy the nation, not some foreign power. He was correct, for even today, the Senate will not ever investigate the Judiciary and there is no committee that even oversees the Judiciary and the decisions they hand down.

Alexander Hamilton

(1755-1804)



While Parliament voted for peace with the American colonies in 1782, it was on September 3rd, 1783 that the formal **Treaty of Paris** was signed ending the Revolution. Congress ratified the treaty in 1784, but it was not until 1787 that the Constitutional Convention agreed to sit down to write the basis of the United States. It was ratified by the states in 1788 and the Federal Government officially began on March 4th, 1789. It was thus in 1789 that Congress enacted the first tariff. The first census was taken in 1790 showing the population at 3,929,625.

There was a serious problem. What was going to happen to all the debt owed by the Continental Congress? It was thus settled that the new government would make good on the old debts of its predecessor, yet that was never done.

<u>Article VI (Federal Constitution)</u>

All Debts contracted and Engagements entered into, before the Adoption of this Constitution, shall be a valid against the United States under this Constitution, as under the Confederation.

Alexander Hamilton was a major Federalist who was determined to create a strong central government. He ended up linking two contentious issues (1) where to create the capital and (2) establishing a bank and debt. In 1790 Hamilton ushered in what was known as the "assumption" plan whereby he proposed to then assume $25 million in state debt as federal because it had been accumulated in a common cause of funding the Revolution. This was linked with locating the new capital more in the South on the Potamac river to get the vote of Virginia. This plan was at first defeated on April 12th, 1790 and then linked with the moving of the capital to create the great compromise of 1790. The deal passed both houses on July 12th, 1790. Hamilton's motive was to relieve the states and thereby made the federal government even stronger.

Hamilton's second plan was to create a central bank. He obtained the votes needed on February 25th, 1791 over the opposition of both Madison and Jefferson. **David McCullough** reported in his great historical account of **John Adams**, regarding the private correspondence of Abigail Adams who wanted to invest in the new government securities created by Hamilton, stating "Mr. Adams held to his faith in land as true wealth." Id./p428.

Panic of 1791

McCullough goes on to point out that "Adams not only put his trust in land as the safest of investments, but agreed in theory with Jefferson and Madison that an agricultural society was inherently more stable than any other - not to say more virtuous." Id./p 428.

Indeed, Hamilton had made an offer that the Continental Currency would be exchanged for 100:1 for US dollars in the form of a new public debt. This had the effect on the one hand of creating an image that the new Federal Government would honor its words and redeem the old currency that many assumed would be at par. Those who did not want to wait, could exchange it then and there at the 100:1 ratic in new debt. Those who did take this deal, became very wealthy. Those who clung to the old currency and waited, died and the currency merely became items for collectors. The US government defaulted on that debt like every other state in the history of mankind and civilization. It was this event that created the first financial panic in the new government.

The Panic of 1791

The panic of 1791 was the first to take place in the United States, and it illustrates how expectations always exceed realistic events. The old maxim **Buy the Rumor & sell the news**, is one of the greatest truths ever put into words. The expectations of the new Bank of the United States had set off a speculative bubble in an anticipation of what would emerge. The bank script in the new United States Bank rose from 100 to 195 dollars. When the panic struck, the price collapsed 110, and then there was the bear market rally back to 145.

This was the first government intervention for Hamilton then authorized the Bank of New York to buy government bonds and stocks to inject cash into the system to help stem the economic collapse due to a shortage of money. This became the first **Open Market** position so to speak buying government paper to add cash to the system.

The land values, however, were declining for the large part due to a shortage of cash and credit. Keep in mind there were no such 30 year mortgages.

The creation of the **First Bank of the United States** had a deflationary impact upon the new economy that was unintended, and not understood at the time. The creation of this bank by Hamilton was the cornerstone in his mind of creating a new strong central form of government and thus nation. He envisioned the bank would be able to administer his fiscal policy that was to fund the public debt left behind by the Revolution. He also saw this as the means to facilitate a stable national currency, and to provide a clearing house for the private banking notes. For you see, the banking model goes bank to the Greeks where the temple to gods received great wealth as a donation. The Temple at Delos emerged as a ancient central bank. It acquired great stores of wealth and kings would borrow to fund things as war. Thus, banks emerged more as a safe place to keep one's wealth and to then transfer gold from one person to another we find the use of receipts. It was this key structure that gave birth to these receipts emerging as notes issued by individual banks and traded in barer form.

What you must understand, is that this was the system of banking. There were many notes circulating by different banks. They were not government issues. Hence, this is where Hamilton's creation had the effect of placing a check upon the creation of money by private banks with no real assets to back their issues.

The **First Bank of the United States** was chartered in 1791 with a capitalization of $10 million. The subscription of stock was indeed virtually funded with a vast amount of bids overnight. The federal government bought 20% and a substantial portion was purchased by the Europeans, perhaps as much as 33%.

The deflationary role created by the bank was clearly unforeseen. No one knew precisely how a national bank would operate. The money supply was thus entirely composed of foreign coin and paper currency issued by private banking establishments. There was a difference in the value of money between the colonies. For example,, the coinage circulating was in part minted by each colony with silver coinage being foreign coins of Britain, France, Spain, and Germany. Foreign exchange rates varied greatly for in in New England it was 6 shillings = $1, but in New York it was 8 shillings.

Hamilton set up the First Bank of the United States to have various offices at the major seaports and commerical centers to act as a depository for the federal government collecting tariffs. However, because the bulk of the money supply was this paper currency issued by state banks, the unexpected effect was that it stemmed the tide of speculation that could be fueled by these banks just then issuing notes. Because the tariffs were often paid in these notes, the bank then "put" these notes to the issuing banks requesting gold and silver. **This was the deflationary check against the limitless issue of paper money.**

Natrually, there was resentment against this natural check against inflation, and the resistance began to grow. This is why the **First Bank of the United States** was disliked and its 20 year charter expired in 1811.

The demise of the central bank did precisely what those who hated it wanted. It led to widespread inflation and an instable money supply. It was eventually recharted in 1816 only to be attacked again and destroyed by Andrew Jackson.

Consequently, we had a deflationary trend for the first 8.6 years into the end of this was in 1799. It was not a profound collapse per se, but rather a slow squeezing out of speculation after the bubble in 1791.

It was 1792 that trading stocks began in New York under a tree on old Wall Street. We also see the tax on whiskey led to the **Whiskey Rebellion** in 1794. We have the **XYZ Affair** and France insults America in 1797. In 1799, we begin to see a new beginning. There was even at this time the Russian-American trading company established in Alaska. Yet, as always, the Government turns against its people when this cycle goes into major lows. It was 1798 that Congress enacted the **Alien & Sedition Act** that even caused Jefferson to stop meeting and writing letters. George Washington also died on December 14th, 1799. In 1800, the new US Federal Government moved to Washington, DC. In 1801, Tripoli declared war on the US which refused to pay tribute to the Arabs for free passage across the Atlantic. By June 4th, 1805 Tripoli was forced to end its piracy and enter into a peace treaty with the USA and that now sets the stage for economic growth in the area of international trade for the new cycle.

1799 - 1851

Our next wave between 1799 and 1851 was filled with land speculation and culminates in a major high in 1851 that is sparked by the wave of inflation due to the California Gold Rush. Indeed for the first time created a $50 octagonal gold piece to be struck in California reflecting the regional inflation that go to the point that a room rose in rent to as much a $1,000 per month! This was a major high in real estate that lasted for 26 years effected also by the Civil War that devasted real estate values.

This wave would collapse into 1877 and move counter trend to the rest of the economy since we have the main economic peak in 1878 that was followed by high volatility through many panics and the 1896 bailout of the US Treasury by J.P. Morgan.

1877 - 1929

During this wave we have raw land values rising with the expansion of the railroads. There would be many swings on the minor turns throughout this wave, but again we culminate with the 1929 Crash preceded by the Florida land boom in the 1920s. This bubble crashes and where land values were $1 per acre in the 1830s, they fell to as low as 30 cents during the Great Depression.

What you will see here is that this was a convergence of the Real Estate model with the **ECM** that did not exist on the previous turns. This wave reached a low in 1934, with a rally into 1937, and a final crash into the 26 year low for 1955.

1955 - 2007

For those who are unfamiliar with the real estate history of the East Coast, what we have that began in 1946 was the birth of a developer **Levitt and Sons, Inc** who had a dream of how to create suburbanization for the returning GIs. Their concept was to create a preplanned and mass-produced housing model with thousands of low-cost homes accompanied with shopping centers, playgrounds, swimming pools, community centers, and schools.

Levitt and Sons, Inc began in 1946 with their first project in Nassau County, Long Island, New York. What they created was a model that was quickly adopted starting in 1955 and became pictured in movies. They created the image of suburbia.

Their second project took place in Bucks Country Pennsylvania near the Delaware River not far from Trenton, New Jersey to the North and Philadelphia to the South. This project was under construction between 1951 and 1955. The names of these complete towns was **Levittown.**

A third prject was built in New Jersey between 1955 and 1959 with a shopping mall at the center. The region was originally **Wellingborough** that was settled by Quakers in 1677 and the name became corrupted to be just **Willingboro.** In 1959, the name was formally changed to **Levittown,** but later the people had it changed back to **Willingboro** in 1963.

In fact, President John F. Kennedy went to then **Levittown, New Jersey,** during the election of 1960. My father took me there to listen to his speech and I even shook his hand that day. But unlike Bill Clinton, I was not moved to run for President.

The recession of 1976-1977 was very bad on housing. I personally was trying to sell a home and move. My house was up for sale over 1 year and nobody even came to look. The first person that put in an offer, I grabbed it and ran moving closer to work since I was a single parent raising two kids.

This wave was targeted to 2007. The first major turn after 1929 on this model. The leverage that made this entire wave, the facilitation of 30 year mortgages, allowed housing to rise in value as the average home owner could now bring forward 30 years of earnings that causes housing prices to rise.

This cycle was sent into an extreme high that was a major **Phase Transition** on a global scale for real estate in the United States because investment banks pooled mortages and delinked sound credit because it was no longer based upon individual credit, but the new average of the pool. This created sloppy lending and had the effect of leveraging the entire housing market. Even sound mortgages were undermined by the bad mortgages bringing all prices down.

Real Estate Collapse

WHAT we must understand about this cycle, is that the pooling of mortgages caused banks to no longer truly care about the quality of the debtor. This created a securitized market whereby mortgages were being grouped together into pools and resold. No one really understood what they were doing. They do not sit down and consider **what if** this new product blows-up. They are only interested in making a buck and selling the product to someone else. If it blows-up, that is their problem. They did not understand what if a individual in the pool defaulted. In a court of law, you have to produce the certified mortgage to demonstrate your legal title to foreclose. But the mortgages were pooled. Some were sliced and diced stripping off coupons and selling them separately. All of a sudden, a homeowner defaults, and nobody actually holds the certified mortgage because it has been cut-up and repackaged in numerous ways. A couple of people in that position due to being in jail, asked me for advice. I told them just to write and ask for a copy of the certified mortgage. They did. The quick response. They will postpone the foreclosure hearing until the person is released. Guess why! The mortgage was pooled.

Oddly enough, we are in a similar type of position as took place following the high in 1773 going into 1799. Shays' Rebellion was caused by the squeeze that we see taking place right now. Declining values and rising taxes. This has materialized in the loss of the Governorship in New Jersey of the Democrat passing to the Republican, because there was no effort to reform government reducing its cost. States often rely on sales taxes and property taxes. In a economic decline, we see their revenues also drop sharply.

We are headed into a decline in prices well into 2012. There should be a recovery into 2015, but there will be no new highs. Thereafter, we should see prices under real pressure because what we are looking at is collapsing availability of 30 year money.

What we have is total confusion right now. Many states have outlawed lease backs that would allow the homeowner to stay in his home until he can afford to buy it back. We find states outlawing this workout because they see this as costing the homeowner more money. In Massachusetts, they have gone as far as forbidding anyone to make one cent on a restructuring. By doing this, they are in fact ensuring that there will be major new defaults foreclosing economic innovation.

Now we have FANNE MAE adopting the very lease back structure that many states have outlawed. In other words, the Federal Government will now buy the homes and lease them back to the homeowner. This whole mess is getting much worse with no end in sight but 2012 in the short-term.

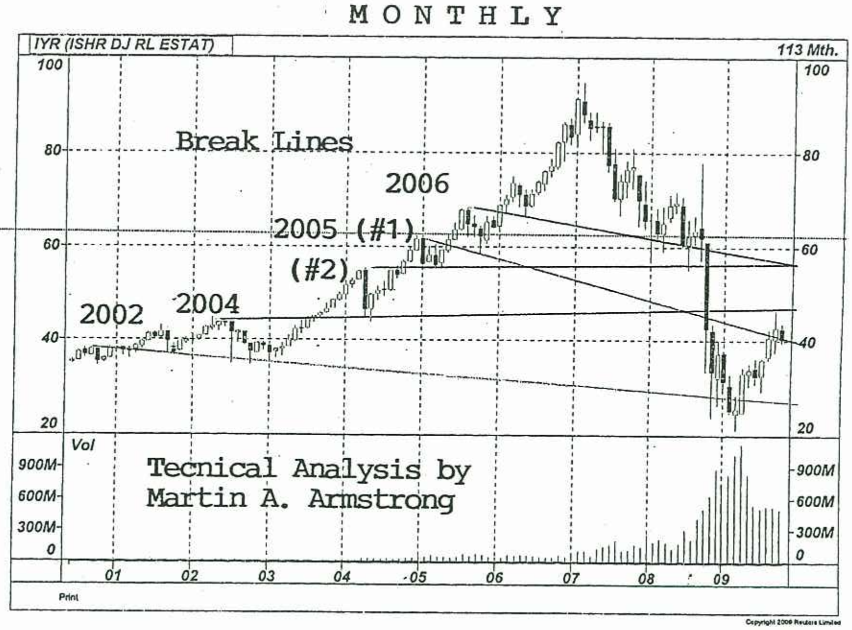
Because of the seriousness of the scope involved, the glut of over-leveraged debt will keep a ceiling on prices. We have a vast number of people who have bought homes in the last 5-6 years, prior to the 2007 high, whose mortgages are now higher than the value of the property. This is also the same problem that was faced by **Julius Caesar.** He was forced to resolve it by cancelling all interest payments made in the past and applying them to capital valued at the time the property was purchased. That was his solution.

There is precious little government can do but keep throwing wood on the fire. There is no one who thinks out of the box, and this has illustrated the stark difference between domestic traditional bankers and domestic fund managers who just don't get it and never will. The hedge fund managers are more dynamic in their thinking because they have at least looked outwardly and seen the complexity of the world in contrast to the traditional **Fish Bowl Economists** and **Analysts** who can only see domestic issues.

As the pressure continues to rise on the states for revenue, the longer they refused to reform, the worse the economic implosion will become. Taxes cannot rise in economic downturns. This is economic suicide on a grand scale.

Because this is a slower moving cycle than even the **Economic Confidence Model,** what we are facing is a very serious 26 year decline into 2033. Even Japan may not see sustainable real estate prices before 2015.

To the right is the index of **Real Estate.** As you can see, this index peaked precisely with the turning point 2007.15 right to the day. This in fact illustrates that we had a very major and huge **Capital Concentration** that was the primary cause of the complete real meltdown that we have suffered.



It was the intense **Capital Concentration** in this sector that produced the major event on this particular wave. As I have stated many times, each sector has its own cycle that is a harmonic or derivative of the overall 8.6 yr frequency.

In the instant case regarding real estate, the overall cyclical wave length is 78 years with a much more prolonged leg for the decline. This is caused by the fact we are dealing with the largest asset class that is profound insofar as its effect reaches the entire scope of the economy from rich to poor as well as sectorial trends between private homes to income producing commercial real estate.

We can see from the technical perspective and with the more detailed discussion in the last report, what we are facing here is a very serious change in trend. We will begin to see a decline resume next year in 2010 and that appears to be headed into a low for 2012. There may be an inflationary rally into 2015, but the primary focus will still be the more liquid assets such as stocks and gold.

The major problem with real estate is the state's profound taxation of this asset class whereas if one were to calculate all the taxes paid, it is highly questionable whether or not there is any true net profit after taxes and inflation to further the wealth of the nation.

Normally, we would expect real estate to rally with inflation, especially when that is an inflationary rally on the back of a decline in the confidence of government and its main currency. Nevertheless, while that may be the normal course of action, it is <u>not</u> the true course following a 78 year high.

The greatest problem that real estate will have is the supply from the contraction in debt and the rising levels of taxation. This was the primary reason for the change in party in the November election for governor in New Jersey. This is a warning sign that the politics remains volatile and we should expect to see further swings. The politicians are not likely to comprehend the true reasons for this, but will take it more of a self-interest that feeds their ego that one party is better than the other.

Unless President Obama starts to listen (unlikely), we may even have a one term president because of the economic contraction. Since this is centered within the real estate, it is the sum of all trends that produces the greatest of all economic chaos.

So, be careful with real estate. Hedge it by 30 year fixed borrowings. Stay liquid for in times like the present, cash is king.

EPILOGUE

There are no doubt critics who hate me for what I write threatens them and their status quo. So many of the great minds in history have indeed been proponents of **Cycle Theory.** Some saw the sum of all things and their movement as a cycle that could not be altered. One such genius was that of Benjamin Franklin (1706-1790). H.W. Brands wrote of him in **The First American,** "To genius he joined a passion for virtue." Edmund S. Morgan the Sterling Professor of History at Yale wrote, "We may discover a man with a wisdom about himself that comes only to the great heart." Truly, Franklin was a man who understood the cycles and declared: "Upon the whole, I am much disposed to like the world as I find it, and to doubt my own judgment as to what would mend it." For you see, if more understood the complexity of interaction between all things, we too would be cautious of trying to create utopia forcing our will to then compel the world to do as we desire rather than to understand how it works. Those who want to control the world and reshape it in their own image of perfection, hate my guts for I have no time to write fictional economic studies to in some way support their economic agendas. To the right, I have given the words of Franklin he had written himself for his grave. They are the true expression of his belief in cycles.

The body of
B. Franklin, Printer;
(Like the cover of an old book,
Its contents worn out,
and stripped of its lettering and gilding)
Lies here, food for worms.
But the work shall not be lost:
For it will, (as he believed) appear once more,
In a new and more elegant edition,
Revised and corrected
By the Author.[52]

Even in the New Testament, the devil is to be thrown into the abyss and chained for 1,000 years. "After that he must be set loose for a little while." **Revelation 20,3.** He will again set out to deceive the nations of "Gog and Magog" **Revelation 20,4.** For those who are religious, is this not an expression of a cycle?

Franklin and Thomas Jefferson (1743-1826) were not particularly religious men, but they were moral men who believed in the conscious of man. Jefferson was given a memento for it was truly the passage of the Age of Reason to a spiritual heir. This is why you will find on the reverse side of the Seal of the United States, a Latin phrase - **novus ordo seclorum (a new cycle of the ages).** So those who wish to proclaim by opinion that cycles do not even exist, I for one would say they join the same ranks as those who argued the world was still flat. I see no point is fighting posterity. Franklin also penned: **"He that spits against the wind, spits in his own face."** What will be will be.

We can hedge real estate by locking in long-term debt 30 years fixed. If the world collapses, you will not be alone and unlike in the times of Solon, you will not be sold into slavery (debtor's prison). This is a **DEBT CRISIS** and it is combining with a full blown public debt collapse as well. Without a **slow burn** and a monetization of the whole national debt and truly restructuring of government, we will most like implode and then hopefully we will be able to create a **novus ordo seclorum** minus the whole Marx stuff.