Two Years Into the Worst Financial Crash in History

by John Hoefle

With the worst financial and economic collapse in history now playing out with thinly veiled hysteria in the daily media reports, it is useful to remind your neighbors that Lyndon LaRouche told them it was happening long before it made the pages of the *New York Times*, and that what is happening is the tragic culmination of a process—economic, political, and cultural—which has been playing out for three decades.

As we go to press, the Dow Jones Industrial Average has dropped 1,677 points (18%) in 11 trading days, falling below the level it hit in the aftermath of Sept. 11, to levels not seen since the panic of 1998. As dramatic as that plunge may be, however, falling markets are but a reflection of a deeper and much more ominous process, the sharp decline of the physical economy of the United States, and the world. The real economy has fallen out from under the markets, which have been artificially propped up by accounting tricks, enormous and unpayable debt loads, and mass delusion on the part of the markets and the public.

Reality is now breaking through the delusion. Some people respond by closing their minds and asserting that the market will come back, "because it always does." A more extreme version of this neurosis is the type who views the market slide as an opportunity to buy, forgetting that the "buy low and sell high" philosophy of J.P. Morgan and his parasitic peers made them rich not because they could read the markets, but because they could manipulate them. Then there are those who respond to the crisis by reexamining the axioms which caused them to fall under the spell of the delusions, to figure out why Lyndon LaRouche could see so clearly what they did not. It is the latter group upon which the future of mankind depends.

The Shape of Things To Come

We are now two years into the worst market crash in world history, with the major stock markets already down some 50% from their peaks in 2000. The markets are now back to their 1997-98 levels, but carrying half a decade's more debt, leverage, and speculation. In market terms, we have crossed the peak and are now headed down the back side of a very steep mountain. How far and how fast we fall, is largely a matter of actions taken, or not taken, on fundamental economic policy. As long as the Bush Administration and the Federal Reserve maintain their Hooveresque "the economy is fundamentally sound" stance, we can expect sharp plunges, punctuated by futile attempts to bail out fictitious and unsalvageable market values.

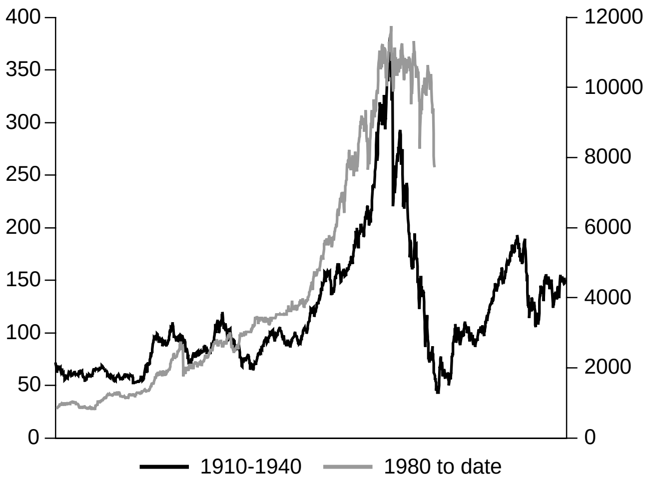
A graphic example of how fast the markets can fall is the sharp plunge in the Dow from a high of 381 in September 1929, to the low 40s in June 1932, a fall of some 90% over two years. The Dow didn't break 100 points again until mid-1933, and did not rise above 300 points until early 1954.

The rise and fall of the Dow since the 1980s bears a striking similarity to the period of the Great Depression, as can be seen in **Figure 1.** This was produced by matching up the peaks in 1929 and 2000, using weekly closings. The run-up in both periods, reflects the process shown in LaRouche's Typical Collapse Function triple curve, in which financial aggregates rise hyperbolically to the point they become unsustainable, and collapse (**Figure 2**).

A similar process can be seen in the rise and fall of WorldCom (**Figure 3**), whose stock soared in the late 1990s and then plunged back to earth in the largest bankruptcy filing ever.

This sharp rise-and-fall curve can be seen in numerous other stock market indices, corporate stock charts, and other

FIGURE 1
Dow Jones Industrial Average, 1910-1940 vs. 1980 To Date



Source: Dow Jones.

FIGURE 2
A Typical Collapse Function

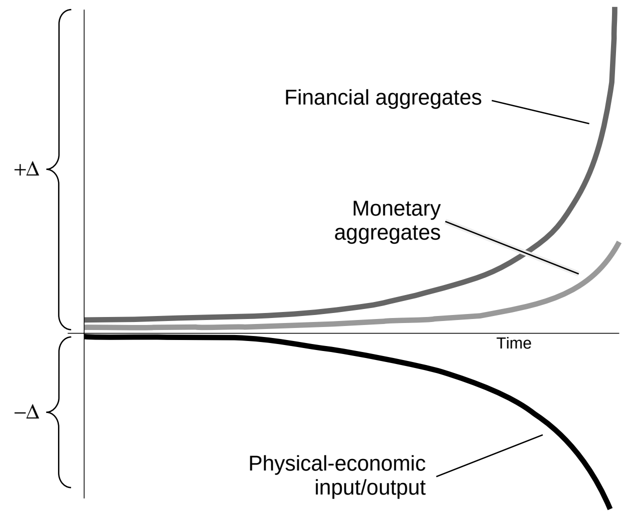
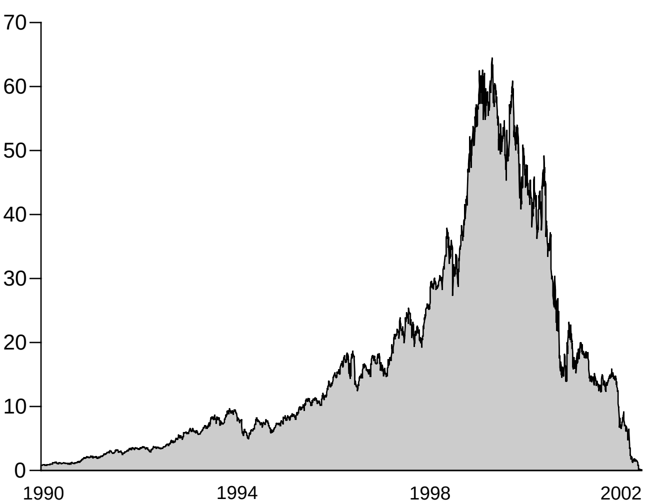


FIGURE 3
WorldCom Closing Stock Price
($ Dollars)



Source: Yahoo! Finance.

economic statistics, though it is often disguised by statistical manipulations and fakery. The pattern can already be seen in the stock prices of the energy pirates and the telecom and computer companies, and is nearly fully formed at semi-industrial companies such as General Electric and some of the big financial institutions. Absent the implementation of LaRouche's emergency policies, it is the shape of things to come for the United States and the world.

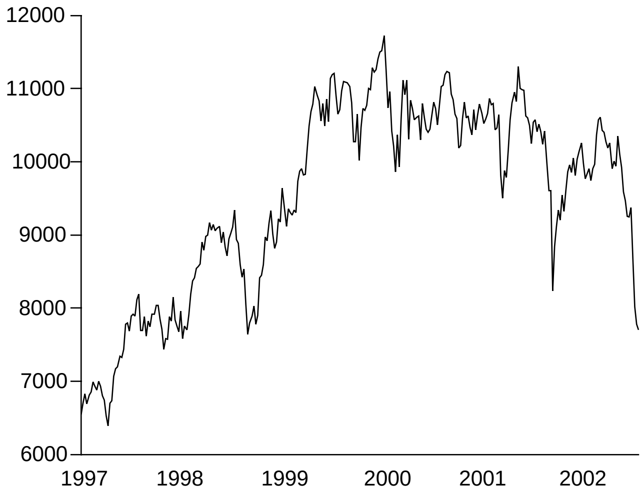
The comparison between now and the Great Depression can only be taken so far, however, because the danger is much greater now. Not only is the bubble relatively much larger than it was then (the Dow increasing by a factor of five in the two decades leading up to the 1929 peak, versus a factor of 15 in the current period), but a much smaller percentage of the population is engaged in farming and manufacturing, and a much higher percentage lives in cities, where they are much more dependent upon urban services and distribution chains. The population is also culturally less prepared to handle the hardships that would flow from a full-scale economic crash. The potential political and cultural breakdowns following a crash could rapidly lead to a new Dark Age, particularly in the cities.

Vaporization

The rise and fall of the global stock markets since 1997-98 can be compared to the volcanic eruption of Mount St. Helens, where the top of the mountain simply vaporized; in the case of the market, trillions of dollars of market capital have disappeared. This process is reflected in the Dow Industrials (**Figure 4**), the S&P 500 (**Figure 5**), and the Wilshire 5000 (**Figure 6**), all of which show a similar peaking curve. The process is more pronounced in the S&P 500 and the Wilshire 5000, which are significantly broader indices than the 30-stock Dow.

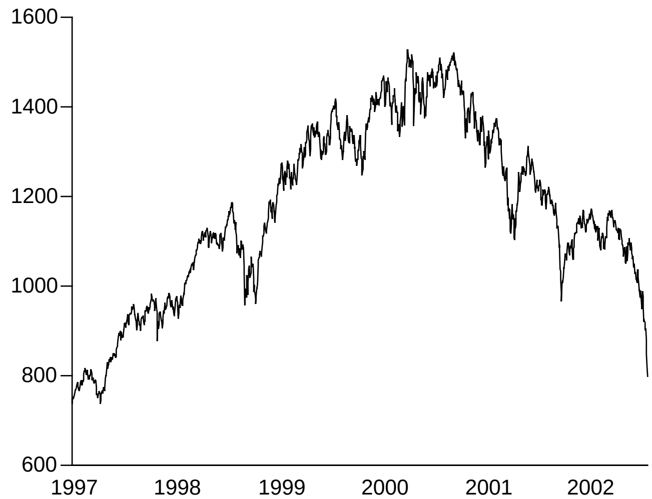
In recent years, the Dow has become more of a psychological manipulation tool than an economic index, as old-economy companies were cast out and replaced by "New Economy" entertainment, information, and services firms. Today's

FIGURE 4
Dow Jones Industrial Average, Weekly Closes 1997-2002



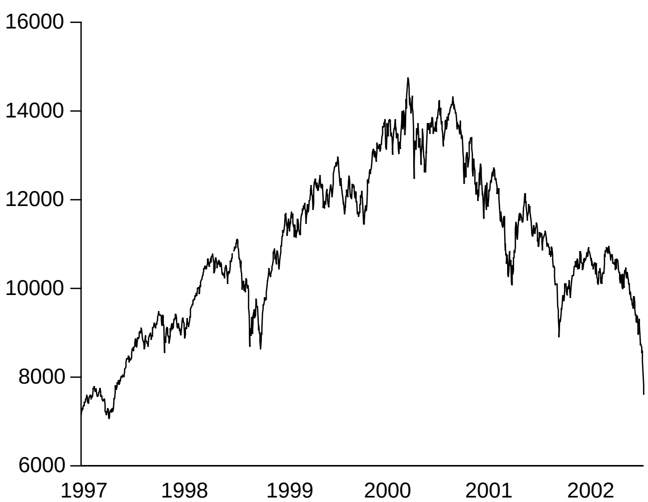
Source: Dow Jones.

FIGURE 5
S&P 500 Daily Closes, 1997-2000



Source: Yahoo! Finance.

FIGURE 6
Wilshire 5000 Daily Closes, 1997-2002



Source: Wilshire Associates.

Dow includes such "industrial" titans as derivatives giants J.P. Morgan Chase and Citigroup; American Express; computer firms Microsoft, Intel, IBM, and HP; Walt Disney Co., Wal-Mart, Home Depot, and McDonald's. Even the firms which do have industrial components have large financial operations; General Electric, for example, makes about half its profit from its financial operations, including a sizable derivatives business.

Because it contains just 30 stocks, the Dow is also relatively easy to manipulate, and the Plunge Protection Team has intervened with increasing frequency when sharp declines threaten to escalate into major panics. Though its actions are semi-secret, the Plunge Team's interventions are easily spotted by the classic "V" pattern in which the market plunges during the morning, then suddenly rebounds sharply during the afternoon.

Such interventions can be effective in dealing with anomalous events within an otherwise sound system, and can even provide a temporary boost during a systemic decline, but no amount of financial stimulus can prevent a systemic collapse when the economic underpinnings of the physical economy have crumbled. There are larger forces at work than can be dealt with by Federal Reserve Chairman Alan Greenspan's bubble-blowing apparatus, especially since the money thrown into the bubble is looted from the underlying economy, making the bubble less supportable with every intervention.

Wall of Money

The nature of Greenspan's dilemma can be seen in the sharp run-up in the markets in the 1997-2000 period, which itself is the result of an attempt to save the system in 1997. In early 1997, British fund manager Tony Dye issued warnings of an imminent disaster in the global derivatives markets, warnings which coincided with reported but downplayed reports of derivatives problems at National Westminster Bank.

Dye's warnings echoed those of LaRouche, who had warned since 1993 that derivatives speculation would indeed blow up the system.

In the over-the-counter derivatives markets, it is relatively easy to keep giant derivatives disasters hidden, because no one knows unless the counterparties tell them. Other market participants and the regulators might find out in short order, but the public is rarely told, especially when the problem is serious. Still, actions taken in the wake of a crisis can provide tell-tale signs.

In the case of the derivatives crisis of 1997, the tell-tale sign was the mid-1997 emergence of the so-called "Asian crisis," which was actually a currency-warfare attack on the Asian Tiger economies by Anglo-American financial interests. In typical form, the bankers were attempting to postpone their own bankruptcy by stealing from the Asians. This assault continued into 1998, targetting one Tiger after another, generating billions of dollars in loot and sending funds fleeing to the relative safety of the U.S. financial markets. The result can be seen in the rise of U.S. stock markets during the period.

The game came to an abrupt halt in September 1998, when looting-target Russia caught the markets off-guard with a default on its GKO bonds and a devaluation of the ruble. The prospect of a sovereign default—the "debt bomb" policy advocated by LaRouche—sent the financial markets into panic, with investors fleeing speculative paper in favor of more secure U.S. and German government bonds. This, in turn, caused many derivatives speculators to hemorrhage money, with the markets moving in the opposite direction from their bets. Long-Term Capital Management, the giant Nobel Laureate hedge fund, went bankrupt and was bailed out by the banks at the urging of the Fed. Many other derivatives players, some considerably bigger than LTCM, were also grievously wounded.

In response, Greenspan and his central banking peers launched what speculator George Soros later called the "wall of money," flooding the markets with liquidity and promises, and a cover-up of the extent of the damage. Only later would the players admit what LaRouche said at the time: that the global financial system came within a hair of melting down in 1998.

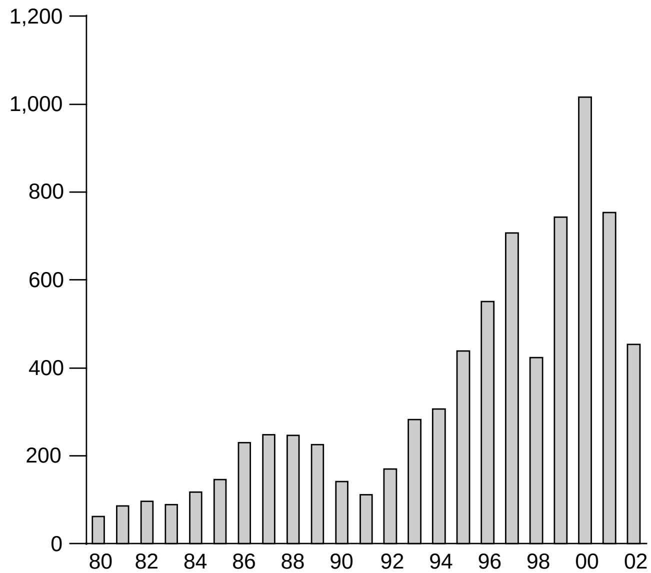
It was this "wall of money" approach, combined with a liquidity injection under the guise of preventing potential Y2K problems and a regulatory blind eye to "creative bookkeeping," which led to the sharp rise in U.S. financial markets from late 1998 into early 2000.

The attempt to bail out the system in 1997 led to the blowup in 1998, at which point another bailout was launched which blew up in 2000. Since then, global markets have plunged, major corporations have collapsed, pensions and retirement funds have evaporated, and the financial system is disintegrating. But don't worry, because a bailout is in the works. After all, the markets always rebound, don't they?

FIGURE 7

Foreign Capital Inflow Into U.S. Drying Up

($ Billions)



Source: Bureau of Economic Analysis, U.S. Dept. of Commerce.

Systemic Crisis

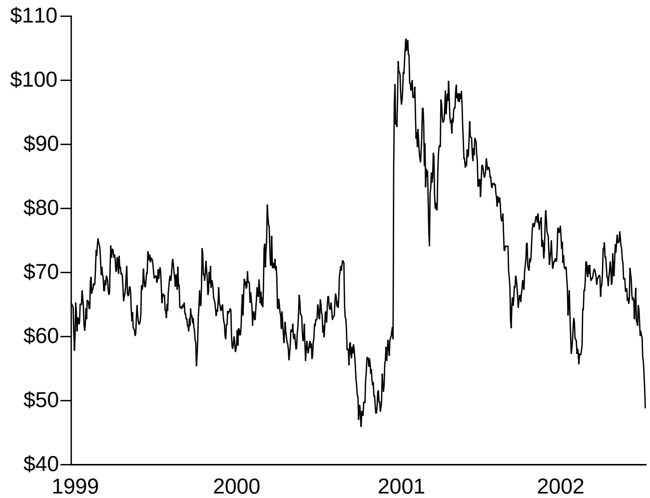
The U.S. stock market bubble was actually a global phenomenon, financed in part by huge flows of investment capital into the country. Money poured into the United States during the go-go 1980s, though that flow ebbed a bit when the U.S. banking system went under (the Fed secretly took control of Citicorp and arranged shotgun marriages for the big banks) after the real estate market collapsed. To save the day, the financiers unleashed the derivatives market, unpayable debt was rolled over, and financial deregulation escalated. Changes in the tax codes allowed money that previously would have been paid in taxes to instead be gambled in the markets, and corporations used money that should have been invested in their business activities to support their stock price. The bubble soared, but the physical economy suffered, as health care, education, transportation, goods production, and research and development were all choked back in order to feed the bubble.

As the bubble grew, the cash poured in, but that process abruptly reversed after the market peaked in 2000 (**Figure 7**). The decline in U.S. stocks led to a decline in the inflow of foreign capital, which in turn further depressed stocks. This process was ameliorated by the strong dollar, because the rising dollar increased the profits of foreign investors as the markets rose, and reduced their losses as the markets fell. However, in 2002, the weakness of the U.S. economy has caused the dollar to fall, including a sharp fall against

FIGURE 8
Dollar Falling Against the Euro
(Euros per Dollar)

Source: Wall Street Journal.

FIGURE 9
J.P. Morgan Chase Vaporizing Market Capitalization, 1999-2002
($ Billions)



Source: Yahoo! Finance.

the euro (**Figure 8**).

The process defined by a falling stock market, a falling dollar, and reduced foreign capital inflows spells doom for the U.S. financial bubble, and when the United States falls, the world falls with it. Add to that the outbreaks of this systemic disease in Japan, Argentina, Brazil, Turkey, and other nations, including growing problems within Europe, and you have a prescription for disaster.

Sinking Banks

In all the corporate disasters breaking out in the United States, two names keep cropping up with uncanny regularity: J.P. Morgan Chase & Co. and Citigroup. Both were major lenders to Enron, and according to a report by the U.S. Senate Permanent Subcommittee for Investigations, both banks were active participants in Enron's fraud, using offshore affiliates to help Enron disguise loans as energy trades. Both banks lent heavily to the energy-pirate and telecom sectors, and are undoubtedly facing losses in the billions of dollars as those sectors vaporize.

J.P. Morgan Chase is the result of the acquisition of J.P. Morgan & Co. by the bigger Chase Manhattan. The deal, which closed on the last day of 2000, has been an absolute disaster as measured in ordinary—and therefore misleading—market terms. The market capitalization of the combined Morgan Chase is now less than that of Chase alone on the day before the merger, with Morgan (or at least its equivalent value) having simply vaporized (**Figure 9**). This is not surprising, as it was likely a bankruptcy at Morgan, and perhaps Chase as well, which led to the takeover of the aristocratic Morgan by the commoners at Chase.

The merger only bought a few months. Indications are that Morgan Chase blew up in mid-2001 and was secretly taken over by the Fed, similar to the way Citigroup's predecessor, Citicorp, was in 1989. During the fourth quarter of 2001, Morgan Chase combined its two lead banks, Chase Manhattan Bank and Morgan Guaranty Trust. As part of that process, $125 billion in assets and $7 trillion in derivatives simply disappeared from the combined banks' books, suggesting major financial problems. Still, with $24 trillion, Morgan Chase has more derivatives than any other bank in the world, and more than enough to make a spectacular explosion.

Citigroup may be under Fed control as well, as rumors of major derivatives losses circulate. Citigroup is the result of the 1998 takeover of Citicorp by Travelers Insurance, creating what is now the largest bank in the United States, with just over $1 trillion in assets and $9 trillion in derivatives. On July 18, Saudi Prince Alwaleed bin Talal, Citigroup's largest individual shareholder, said that he had invested another $500 million in the bank, raising his holding to $10 billion. Alwaleed, a nephew of Saudi King Fahd, obtained his initial stake in the bank shortly after the Fed took it over in 1989 and began arranging a bailout. The latest cash infusion raises suspicion that Alwaleed is performing a similar service for Citigroup.

Not to be left out is Bank of America, whose $620 billion in assets puts it third behind Citigroup's $1 trillion and

Morgan Chase's $713 billion. Bank of America's $10 trillion in derivatives puts it solidly on the hot seat in any financial crisis, and it has also loaned heavily to bankrupt companies. Rumors are flying that Bank of America has applied to the Fed for a secret bailout.

If the Fed winds up running the three biggest banks in the country, who's going to bail out the Fed?

Mutual funds, pension funds, and insurance companies are also big holders of stocks and have been hard hit by the decline. There's a lot more damage out there than has been admitted so far, and the hemorrhaging is continuing.

Pompous Pundits

Those tempted to listen to the siren calls of "recovery" and "sound fundamentals" emanating from the canyons of Wall Street and the nation's capital would do well to recall the comforting assurances given by the pundits and politicians in the period immediately before and just after the crash of 1929:

"Stocks prices have reached what looks like a permanently high plateau. . . . I expect to see the stock market a good deal higher within a few months," Yale economics professor and Hoover adviser Irving Fisher said on Oct. 17, 1929.

"The industrial situation of the United States is absolutely sound," Charles E. Mitchell, chairman of National City Bank of New York (a predecessor of Citigroup), said in early October 1929. "I know of nothing fundamentally wrong with the stock market or with the underlying business and credit structure," Mitchell added on Oct. 22, 1929.

Even after the 13% drop on Black Monday, Oct. 29, 1929, the pundits were urging the public to stay in the market. "This is the time to buy stocks," said market analyst R.W. McNeel on Oct. 30. "This is the time to recall the words of the late J.P. Morgan . . . that any man who is bearish on America will go broke. . . . Many of the low prices as a result of this hysterical selling are not likely to be reached again in many years."

"Financial storm definitely passed," banker Bernard Baruch cabled Winston Churchill in mid-November.

"I see nothing in the present situation that is either menacing or warrants pessimism," Treasury Secretary Andrew Mellon announced on the last day of 1929.

"I am convinced we have now passed through the worst . . . and shall rapidly recover," President Herbert Hoover stated on May 1, 1930.