

# GREEN PARTNERS LLC

September 30, 2010

## Dear Partners,

The elephant in the room continues to be the growing piles of sovereign debt in almost all developed countries. For the sake of brevity, I will keep this letter dedicated to our own country's balance sheet but I believe what is going on with other sovereign debt—namely Japan and China—is equally important and will be addressed in the next letter.

Right now, our federal government is piling on more and more debt while our central bank continues to expand its monetary base on one hand and print money on the other.

Arguably, no other time in history has government participation meant so much to free market ramifications; with significant investment implications as an enormous byproduct.

Exhibit A, below, is a snapshot of “official” net-debt from the Bureau of Public Debt. Since the housing and banking crises began in 2008, the United States Treasury has spent \$4 trillion in unfunded deficit spending.

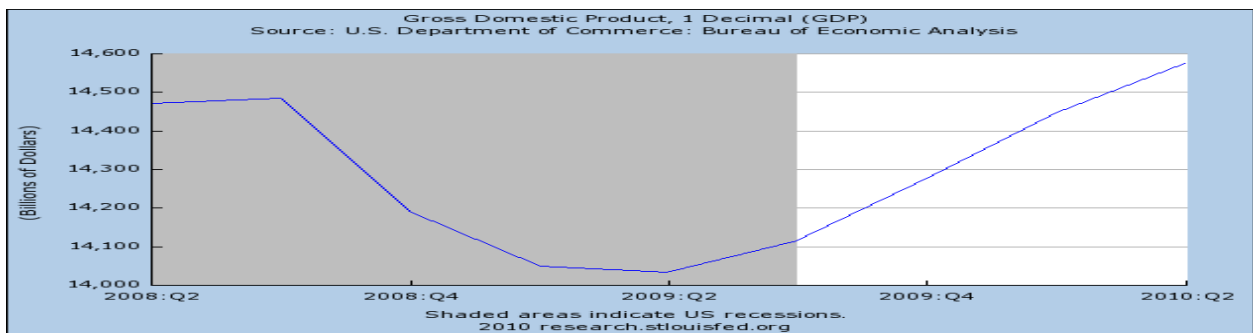
## Exhibit A:

Date	Debt Held by the Public	Intragovernmental Holdings	Total Public Debt Outstanding
06/30/2008	5,285,063,693,378.25	4,206,942,429,625.55	9,492,006,123,003.80

Current	Debt Held by the Public	Intragovernmental Holdings	Total Public Debt Outstanding
09/29/2010	8,933,281,399,898.44	4,502,061,771,289.43	13,466,343,171,187.87

Exhibit B is GDP, the size of our economy, and how much it has grown since the housing and banking crisis began. Per the Bureau of Economic Analysis, the economy has “grown” just a little over \$100 billion since the housing and banking crisis took hold.

## Exhibit B:



Putting the numbers in context, the U.S Treasury, our government, has spent \$4 trillion more than it has collected in tax revenue since mid 2008. Over the same time period, Gross Domestic Product, also known as the size of our economy, has “grown” just over \$100 billion, from roughly \$14.5 trillion to \$14.6 trillion.

Adding it together, every dollar of deficit spending over the last two years has created less than five cents of GDP output. More importantly, the cost to service the debt from the deficit spending since 2008 is higher than the partial tax claim on GDP “Growth” since that time.

The important takeaway is every dollar in deficit spending now subtracts from “real” GDP growth. Some folks call this the Keynesian endpoint, which means you can throw any amount of money you want on all the fires in the economy but it’s akin to pouring more gasoline on the flames. So what’s this mean? With brevity, the purchasing power of the dollar will decline faster than has been typical against the goods and services being purchased, as the deficit spending puts enormous weight on each unit of currency. I am starting to allocate some of our resources to protect us and to take advantage of this phenomenon.

For those with some time, I’ll share the disappearing loaf of bread syndrome we have watched unravel since the introduction of fiat currency 40 years or so ago (Nixon took the dollar off the Gold Standard in the early ‘70s and since then the dollar hasn’t been backed by anything other than the full faith and credit of the United States Government).

Let’s go back to 1965 for just a moment. Those who were purchasers of 20-year U.S. Treasuries at the time were getting a guaranteed 4.2% annual rate of return. One-thousand dollars invested in the 20-year U.S. Treasury in 1965 would have yielded 200 loaves of bread initially; by 1973 that same bond would have yielded 151 loaves, by 1980 the bond’s interest bought 80 loaves of bread. In fifteen years alone, one would have *sustained* a 60% loss of purchasing power.

Assuming one could get a “safe” 4.2% 20-year Treasury bond today—you can’t, the yield is around 3.5%, one thousand dollars invested in the 20-year would yield around 14 loaves of bread. Compounding the problem, when the bond matures the money that comes due over the ensuing years also loses significant and real purchasing power.

While this is the rather ordinary story that your typical financial advisor will share to try to educate clients of the ravages of inflation, stopping here would be telling only part of the story today—leaving out the extraordinary. Alas, most of the populace, including your typical financial advisor, isn’t even aware the *extraordinary* today.

According to our own Congressional Budget Oversight (CBO), our “official” net deficit is expected to continue to grow another \$4.5 trillion—or more—by 2015. How the debt gets funded is where the rubber meets the road from an investment perspective.

Our trade deficits—the money we send out of the country to buy goods and services—is \$375 billion. Assuming an optimistic assumption that the various foreign countries that are the recipients of this wealth—our trade deficits—spend all of their surplus on U.S. Treasuries we still need another \$1 trillion or more to bridge our annual funding gap. Further, assume personal savings in the United States were all directed toward U.S. Treasury purchases to help fund our deficits—quite a stretch given there are many other choices for savings. But if Americans were able to save \$450 billion, well below current savings rates, and directed all of it to fund our deficits we’re still short by \$600+ billion or so.

That leaves one option to fund the remaining deficits. Put simply, the digital printing presses in Washington are running on overtime and will continue for the foreseeable future if our own government's projections are anywhere close to right.

With money being created out of thin air, pressure is put on the dollar as each dollar competes with more dollars. Interestingly, and what most are unaware of, is one can lose significant purchasing power even if prices were declining precipitously as more money is chasing the same goods and services. In essence, you can have deflation in consumer prices—yet still lose real purchasing power.

Naturally, though, many prices are not declining: food, health care, education, and energy related costs to name a few. Therefore, the first knowable implication to our government running such enormous deficits is there will be, at least for awhile, increased devaluation of the dollar over a shorter timeline than the ordinary story of the loaf of bread syndrome. And, importantly, with the Federal Reserve expected to announce another round of Quantitative Easing, QE2—just a more polite way of describing more money printing—on November 3 or December 14<sup>th</sup>, this drumbeat will in all likelihood grow louder.

*The question is this: what happens should there be clarity on these developments and a loss of confidence, perhaps a larger one, in the currency transpires? Were this to transpire, there would be a stampede into assets that would maintain nominal and real value; assets such as Oil, Precious Metals, Agriculture, and other "stored value" type vehicles.*

*This would create enormous, upward pressure on the cost of everyday products while counter intuitively rates on government bonds will drop as the Federal Reserve monetizes its own debt—thereby lowering yields across the entire yield curve spectrum. While there might not be a "clarity" moment, and the debasement of currencies might wane over time, the good news is that many of these stored value assets from an investment standpoint can be bought at sensible prices today, where some of our assets have already been allocated. Just as vital, we don't need dollar debasement for these types of investments to do well over the long term or clarity on dollar debasement as the world's populations grow and should the return of real GDP growth ensue.*

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I believe we're positioning ourselves for the sweet spot while we invest with the Federal Reserve at our backs.

### **Alignment of Interests**

The stock market is down by a third over the last ten years, the housing market has collapsed (and I think it'll be a long time before it comes back), we have witnessed two recessions, a financial crisis, two market crashes of 50% or more, sickening atrocities and ethics from the executives at the largest financial institutions in the world that continues today as they work closely with their buddies in Government (outrageous bonuses on the taxpayer dime, living off Government aid, etc), terrorist attacks and subsequent wars, and anything else you might want to throw in for good measure such as Japan having crossed the Rubicon on fiscal sanity or the bond bubble of 2010/11.

We've come out of these perilous times in excellent shape and are positioned accordingly. I work 60 hours a week—my wife would tell you I work 80—and I have one simple objective: to preserve, protect, and grow your money. I

thank you for your continued confidence and trust in my services. Please continue to tell your friends and family about Green Partners, LLC.

Sincerely,

Nicholas Green