

GREEN PARTNERS^{LLC}

December 31, 2010

Dear Partners,

The markets had a good year; we had a better year—again.

Another round of quantitative easing, also known as printing money, was announced on November 3, 2010. While the announcement from the Federal Reserve fueled a plethora of mainstream attention, debate, and concern that the Federal Reserve has become today's self-elected despot, almost all of what I've heard is backward looking and also fails to connect the all-important dots.

In my last letter I wrote, "How our debt gets funded is where the rubber meets the road today." The summary of my argument, given the finite amount of money in the world, was that there just is not enough capital that exists to fund our ongoing deficits, and printing money would be the only solution to plug our unfunded deficits.

Richard Fisher, of the Federal Reserve, corroborated my arguments in a recent speech with this salient observation:

The Federal Reserve will buy \$110 billion a month in Treasuries, an amount that, annualized, represents the projected deficit of the federal government for next year. For the next eight months, the nation's central bank will be monetizing the federal debt.

This is risky business. We know that history is littered with the economic carcasses of nations that incorporated this as a regular central bank practice.

The only way to stop printing money—monetizing the federal debt—as a regular practice and stop the dollar's decline is in Congress' hands now. They need to curb the fiscal deficits or Americans will face enormous, unintended consequences.

As money tries to move into areas that will retain nominal and real value, prices get bid up—which is one consequence of currency devaluation. In just the last few months, wholesale agricultural commodities have been rising sharply: cotton prices are up 54%, corn prices have risen 29%, soybean prices by 22%, orange juice by 17%, sugar by 51%, and wheat prices have shot up 36%. Oil has been skyrocketing, too, as the price

per barrel has topped \$90 and gas at the pump has just jumped above \$3 per gallon nationwide.

The only policy tool to curtail this type of inflation—when it starts to manifest at the retail level—down the road is for the Federal Reserve to raise interest rates above the real rate of inflation. However, persistent interest rate hikes are unlikely in the U.S. given the high unemployment rate, declining housing market, and large national debts. The Federal Reserve has kept ZIRP (Zero Interest Rate Policy) for almost two years to try to help stabilize housing prices and stimulate new growth.

In the early 1980s, Paul Volcker, the chairman of the Federal Reserve at the time, raised rates above the real rate of inflation to ward off hyperinflation in America. At the time, Volker was demonized by politicians and most fellow citizens; raising the federal funds rate as extreme as he did—20% at one point—caused a recession and increased unemployment and required extraordinary political will on his part, since it meant short term pain for a healthy long-term America. Today, it's unanimous that Volcker was a key contributor for keeping America on its great journey.

My concern is that the Federal Reserve will not be able to afford to raise interest rates above the real rate of inflation, even if they wanted to. For every 1% move higher in our interest rates, our costs to service our national debt jumps by \$120 billion, which would only send our budget deficits skyrocketing further. And unlike the 1980s, even with our current zero interest rate policy, we already have high unemployment and a weak economy and a national debt that is 17 times larger. Since raising rates above the real rate of inflation appears unlikely—out of control prices are a real possibility in the coming years.

Since our inflation is being created by printing money and expanding our national deficits and not from a healthy economy, congress needs to get a handle on this—quickly. When money is created out of thin air, it starts to distort prices like we're seeing in oil and agricultural markets. Imagine someone constantly dumping new money into a game of Monopoly because a few participants are having trouble—its effect is a distortion of prices and a loss of purchasing power due to the unevenly distributed flow of money, where the trouble makers get rewarded at the expense of everyone else in the game.

To keep prices from spiraling out of control, Congress needs to curb \$1 trillion plus in unfunded deficit spending to maintain the integrity of the dollar while, at the same time, not hurt the frail economy by doing so. It will be no easy task.

In fact, we continue to go the opposite way toward fiscal sanity. The Bush tax cuts were recently extended but there has been no reduction in government spending to offset the lower tax revenues that will be coming into the U.S. Treasury. Estimates have this adding another \$900 billion to national deficits in the next two years.

This will put our unfunded deficit in 2011 at roughly \$1.5 trillion or more, much of which will have to be monetized by the Federal Reserve. And by this time next year, we'll have a national deficit larger than our economy.

Though many will be taken aback when another round of money printing is announced, given these numbers—and that states will likely need even more bailout money, I'm not sure why, since there isn't enough money to plug our unfunded deficits without resorting to the digital printing presses.

I continue to believe allocating capital to protect us from what appears to be ramped up dollar devaluation is the judicious course to take. As always, I'll stay tuned in to these all-important developments.

Alignment of Interests

Members of the FBI have been busting into the doors of just about every major investment firm—from 100 year old Wellington Management (who sub-advises mutual funds at Vanguard, Hartford, and many other places), to the once beloved and now beleaguered Janus Capital, to the yes-they-are-at-it-again Goldman Sachs and Morgan Stanley, to Citadel, to many more for alleged insider trading in huge “expert networks” rigged only for their elite, multi-billion dollar clients.

Yet, their model portfolios still leave a lot to be desired.

Please continue to tell your friends and family about Green Partners, LLC where I continue to have no Wall Street contacts of any kind, didn't need any of your tax money to keep my company from going bankrupt, and didn't use obscure derivatives to turn the housing market into a casino at the expense of America.

Sincerely,

Nicholas Green