NEW YORK TIMES BESTSELLER

FROM THE AUTHORS WHO PREDICTED THE FIRST FINANCIAL MELTDOWN

"As bitter as it is, *Aftershock's* message—that America has yet to pay its bills—deserves an audience. After all, the authors were right once before."
—THE WALL STREET JOURNAL Marketbeat

AFTERSHOCK

Protect Yourself and Profit in the Next Global Financial Meltdown

REVISED AND UPDATED

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FOURTH EDITION

Aftershock

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WILEY

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Executive Summary

What Is a Bubble?

An asset value that temporarily booms and eventually busts, based on changing investor psychology, rather than on underlying fundamental economic drivers that are sustainable over time.

What Is a Bubble Economy?

An economy that grows in a virtuous upward spiral of multiple, rising bubbles (real estate, stocks, private debt, dollar, and government debt) that interact to drive each other up, and that will inevitably fall in a vicious downward spiral as each falling bubble puts downward pressure on the rest, eventually pulling the whole economy down.

What Is the Aftershock?

In Phase 1, the real estate, stock, private debt, and discretionary spending bubbles began to fall.

Next, in Phase 2, just when many people think the worst is over, the dollar and government debt bubbles will pop, bringing on the worldwide Aftershock.

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David Wiedemer

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Robert Wiedemer

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Preface to the Fourth Edition of *Aftershock*

Judging from the stock market in 2013 and 2014, as well as the outlook of many investment professionals, it appears we have passed the financial crisis (which we know was caused by the early popping of the bubble economy), and there will be no Aftershock.

That would be welcome and comfortable news—if only it were true.

Instead, what has happened since the 2008 financial crisis is just as we predicted in our earlier books. As the four interacting bubbles (stocks, housing, private credit, and consumer spending) pop, they will put enormous pressure on the two remaining—and much more fundamental—bubbles in our bubble economy: the government debt and dollar bubbles.

That's because there has been an enormous incentive to further inflate the government debt and dollar bubbles in an effort to stall the popping of the other bubbles. And that is exactly what the government has done in two ways. First, it has doubled the national debt from $9 trillion in 2007 to $18 trillion in 2015, pumping up the government debt bubble. And even more stunningly, it has increased the U.S. money supply by an unthinkable 400 percent (from $800 billion in 2008 to more than $4 trillion as of early 2015), pumping up the dollar bubble.

By inflating these bubbles even more, we are temporarily preventing the other bubbles from deflating further and, in some cases, such as the stock market, we are actually reinflating the bubble to some extent. This was most clearly shown in late 2013 when Fed Chairman Ben Bernanke announced another round of money printing (via the third round of quantitative easing, QE3), and the stock market not only avoided what would have likely been a 10 to 15 percent decline in the year but also enjoyed more than a

10 percent gain. By early 2015, the Dow had reached a new milestone of 18,000. As of this writing, the Fed has powered down the printing press but continues to assure Wall Street that it will be ready to go again if necessary.

With great short-term benefits like this, further increases in the government debt bubble and the dollar bubble are likely to continue. Until we actually see inflation or have problems selling our government debt, there is no compelling, immediate reason to face, or even admit, any future problem with inflation or debt. Of course, now that we have shown an enormous willingness to print money in order to buy our own government debt, we will always be able to sell it. So the only real future problem with this scenario comes when concerns over the sustainability and long-term consequences of that money printing become too great for stock market investors.

In fact, we could pump up the government debt and dollar bubbles even more and truly boost the economy into high gear. Double the deficit or triple the money supply again and, no doubt, stocks, housing, and the economy will improve dramatically along with the overall economy. Only if people fear the long-term consequences of these actions will they become a problem. The story of the economy and of financial markets has become less a story about various market forces and increasingly more a desperate fight between investor fantasy psychology and the deeper reality of what's actually happening in the economy.

As long as investors and politicians can ignore the future consequences, there is no short-term reason not to pump up the government debt and dollar bubbles. In fact, there is good short-term rationale for continuing, because if the government were to cut our federal deficit back down to where it was in 2007, before the financial crisis, the government almost certainly would cause a major recession that would immediately pop the stock, housing, private credit, and consumer spending bubbles again. The same is true for the money supply. If we took out all the money we have printed since the financial crisis of 2008, we would certainly cause another bubble-popping recession.

But here's the catch. The only thing worse than the recession that would result from purposely deflating our government debt and dollar bubbles now will be the much, much bigger global depression that will eventually result from pumping them up even further. Deflating these bubbles now would pop our multibubble economy, but continuing to inflate them will eventually cause an even more massive and destructive pop in the future. Even just stopping money printing will lead to a collapse in the stock market and in the greater economy if we don't start printing again. But we can have either pain now or a whole lot more pain later. As it stands, we have chosen a whole lot more pain later.

So we have successfully postponed the Aftershock. How long we can postpone it depends on the government's recklessness and the investment community's continued willingness to believe in the fantasy that nothing but good will come from massive government borrowing and massive money printing.

We don't think the Aftershock can be postponed much longer, but, as we said in the book, that is largely a matter of governmental decisions and investor psychology. Could it be five years away? We think that is unlikely. Could it be just one year away? We think that is probably equally unlikely. Exactly when the Aftershock will hit is hard to say because there is no easy way to predict governmental actions or investor psychology. Best guess: two to four years.

Whatever happens, it will certainly be interesting to see how this story plays out, even if we already know how the story ends. Too bad it's not just a story.

Introduction: Your Guide to the Fourth Edition of *Aftershock*

This fourth edition of *Aftershock* contains a number of important updates and clarifications to the previous book. We have been fortunate to have received lots of excellent feedback and suggestions from our readers, much of which we have incorporated into this new book. Some important changes include the updating of Chapter 1, "This Recovery Is 100 Percent Fake," as well as updates to more than 20 charts and other information throughout the book.

We have added charts, cartoons, and sidebars that we thought were especially relevant at this point in the road to the Aftershock. We have also added a new Chapter 8, "You're No Fun," which gives the personal and humorous viewpoint of *Aftershock* co-author Robert Wiedemer on the state of economic denial that he has found in the minds of many people in the investment community during his travels across this great country.

As before, we have also addressed in detail the obvious question of why inflation has not yet occurred, despite the massive money printing by the Federal Reserve. We discuss how this will affect the Aftershock and, in Chapter 4, we address the role we see inflation playing in the downfall of the stock and bond markets.

Finally, we want to take this opportunity to thank our readers for the incredible support they have shown us. We couldn't have asked for a better response. Many people have told us how much they enjoyed the book, sometimes reading it multiple times, and even giving extra copies to their friends and relatives. Wow—thank you, thank you, thank you!!! It is deeply satisfying to know we are being read, understood, and even appreciated. It's just fantastic!

It's also great that so many of you are helping us get the word out to help as many people as possible. That is so important to us. Hence, we give away free books, and we also make free presentations to worthy organizations. We want to get the word out as quickly as we can and as widely as possible. We hope that this updated edition of *Aftershock* will be an important step in our mission to help people better understand what is going on with the economy, so that they can act now to protect themselves and to prosper in these most unusual times. We hope you find this fourth edition of *Aftershock* helpful in the months and years ahead.

PART I

THE COMING AFTERSHOCK

CHAPTER 1

This Recovery Is 100 Percent Fake

WHY THE AFTERSHOCK HAS NOT BEEN CANCELED

We open this fourth edition of *Aftershock* (2015) with the same chapter title we used in the third edition of *Aftershock* (2014) and in the second edition of *The Aftershock Investor* (2013). Notice a pattern? The so-called recovery was 100 percent fake back then and it's still fake today. Even if you've already read an earlier version of this chapter, you may want to take a look at it again. The updated evidence here that reveals the bogus "recovery" is just as compelling today as it was a few years ago. In fact, it's even more damning.

But don't expect many people to point it out. The economic cheerleaders and bubble-blind experts from whom most people get their financial news are simply not going to warn you about what is really going on or tell you how to protect yourself. They either don't see what's coming or they don't want you to. With stocks hitting new highs and home prices rising, it's pretty easy for the "experts" to convince the public (and themselves) to think that all is well or soon will be. The economy, they tell us, is in recovery, and the coming Aftershock, our critics say, has been canceled.

How wonderful that would be—if only it were true. But nothing has happened to change our minds about our earlier forecasts. In fact, current events fall in line pretty well with our previous analysis and predictions, dating back to our earliest books, *America's Bubble Economy* in 2006 and the first edition of *Aftershock* in 2009.

From the beginning, we said that massive federal government support would keep the bubble economy going as long as possible. Through massive money printing and massive money borrowing, the stock market bubble, along with the real estate, private debt, and consumer spending bubbles have been reinflated. That is the only way to keep this temporary bubble party going, and the government is doing all it can to keep pumping helium into the balloons. This government stimulus to support the bubble economy has pumped up two additional bubbles: the dollar and the government debt bubbles. With the total national debt now more than $18 trillion and the Federal Reserve having radically increased the U.S. money supply to more than $4 trillion (a quintupling increase since 2008), our predictions are looking pretty spot-on.

We never said the stock market wouldn't rise as a result of the stimulus—in fact, it may go even higher. We never said the economy couldn't temporarily stabilize or that home prices couldn't rise in some areas in the short term. We said this is a bubble economy and that the government will do anything it can to keep the bubbles going—and that is exactly what they are doing with so much money printing and borrowing. But please don't confuse a temporary, artificially created stock market recovery or a modest economic recovery with the real thing. Any recovery that is created by massive government stimulus and can be maintained only with continued massive government stimulus is a *fake* recovery.

Why? Because the fundamental economic realities have not changed, and even massive government stimulus cannot permanently override the fundamentals. The fact is that since the early 1980s we have been living in a *bubble economy* (see Chapter 2 for why we say so), and bubbles don't last forever. We saw the beginning of the pop with the partial decline of the real estate bubble in 2007, which helped kick off the stock market decline and global financial crisis of late 2008. Since then, we've seen a mammoth effort to partially reinflate and maintain the sagging bubbles with ongoing government stimulus.

So contrary to popular belief, this "recovery" in the stock market and the overall economy is 100 percent fake and the Aftershock has *not* been canceled.

Isn't a Fake Recovery Better than No Recovery at All?

That seems true, but it really isn't. The massive money printing and borrowing that is creating this fake recovery and delaying the Aftershock will only make the coming crash all the worse later. That's why we say it's nothing to cheer about. A fake recovery may feel good now—like postponing a trip to the dentist with a strong painkiller—but it will only bring us much more pain later.

"Now we just have to sit back and wait for the Fed to bail us out."

Not only will the temporary painkiller eventually wear off, but the medicine itself will later become a poison.

And, of course, just like postponing a trip to the dentist, putting off dealing with our underlying problems only increases our future pain because it postpones the fundamental changes we desperately need to make in order to create a real economic recovery. What we need is not more government borrowing and more dollars created out of thin air to keep the party going. What we need is a true economic recovery based on fundamental changes that will boost real productivity (the subject of future books). Real productivity growth would generate real economic growth and real, nonbubble wealth that would not be vulnerable to bubble pops.

The problem is that those changes are difficult. No one wants to hear that we have to make tough choices and endure a lot of pain now to create real economic growth later. It's much easier to let the government borrow and print for now, and kick all the rest of it down the road. Politicians might talk about fiscal and monetary responsibility, but the short-term consequences of stopping the current bubble-supporting machine would put their jobs in jeopardy. This is why we have been predicting since 2006 that our bubble economy will continue to be maintained until that maintenance is no longer possible. We will throw everything at it until it no longer works and eventually explodes. While marginally effective in the short term, eventually this strategy will fail. Until then, no one wants to pop the temporary bubble party.

Inflation or Deflation?

Nobel Prize–winning economist Milton Friedman in the 1970s famously said: "Inflation is always and everywhere a monetary phenomenon."

In fact, inflation and deflation are both "monetary phenomena," meaning they both result from changes in the money supply. Inflation results from *increasing* the money supply faster than the economy grows, devaluing the dollar and causing goods and services to cost more. Deflation results from *decreasing* the money supply relative to the economy, pushing up the value of the dollar and causing goods and services to cost less.

The Great Depression gave us deflation, not inflation. Too few dollars relative to the economic needs of the time caused the value of the dollar to rise, and the cost of goods and services to fall.