

# **CORNERSTONE INVESTORS NETWORK**

## **ANNUAL ECONOMIC OUTLOOK and MARKET FORECAST**

**by Stewart Bishop  
June 17, 2006**



Archives at: <http://www.FullHouseTrader.com>

# **“MARKET TURMOIL”**

**The past 5 weeks, starting in early May 2006 has witnessed a confluence of market price adjustment and outright turmoil that rivals anything we’ve seen in recent years.**

**Stocks, Bonds, Currency, Gold, Energy, other commodities, and the related economic outlook have Undergone dramatic change in a short timeframe.**

**When in turmoil, markets tend to move rapidly, to “flee”, and to pressure prices up or down until new “comfort zones” are established.**

**Today we’ll look at the causes, the direction, the probable extent, and the implications of this turmoil.**

## **MAY 2006: CONFLUENCE OF MAJOR ECONOMIC & MARKET ISSUES**

- 1) Global baby-boom retirement problem**
- 2) Int'l finance of the U.S. "twin deficits"**
- 3) Housing Bubble questions**
- 4) Financially exhausted consumer**
- 5) Abrupt global stock market selloff**
- 6) Downward turn in the U.S. Dollar**
- 7) Dramatic rallies in Gold & other metals**

## **JUNE 2006: WHAT'S CHANGED ?**

- 1) Currency direction less clear**
- 2) Dramatic SELLOFFS in Gold, etc.**
- 3) Bond rally underway**

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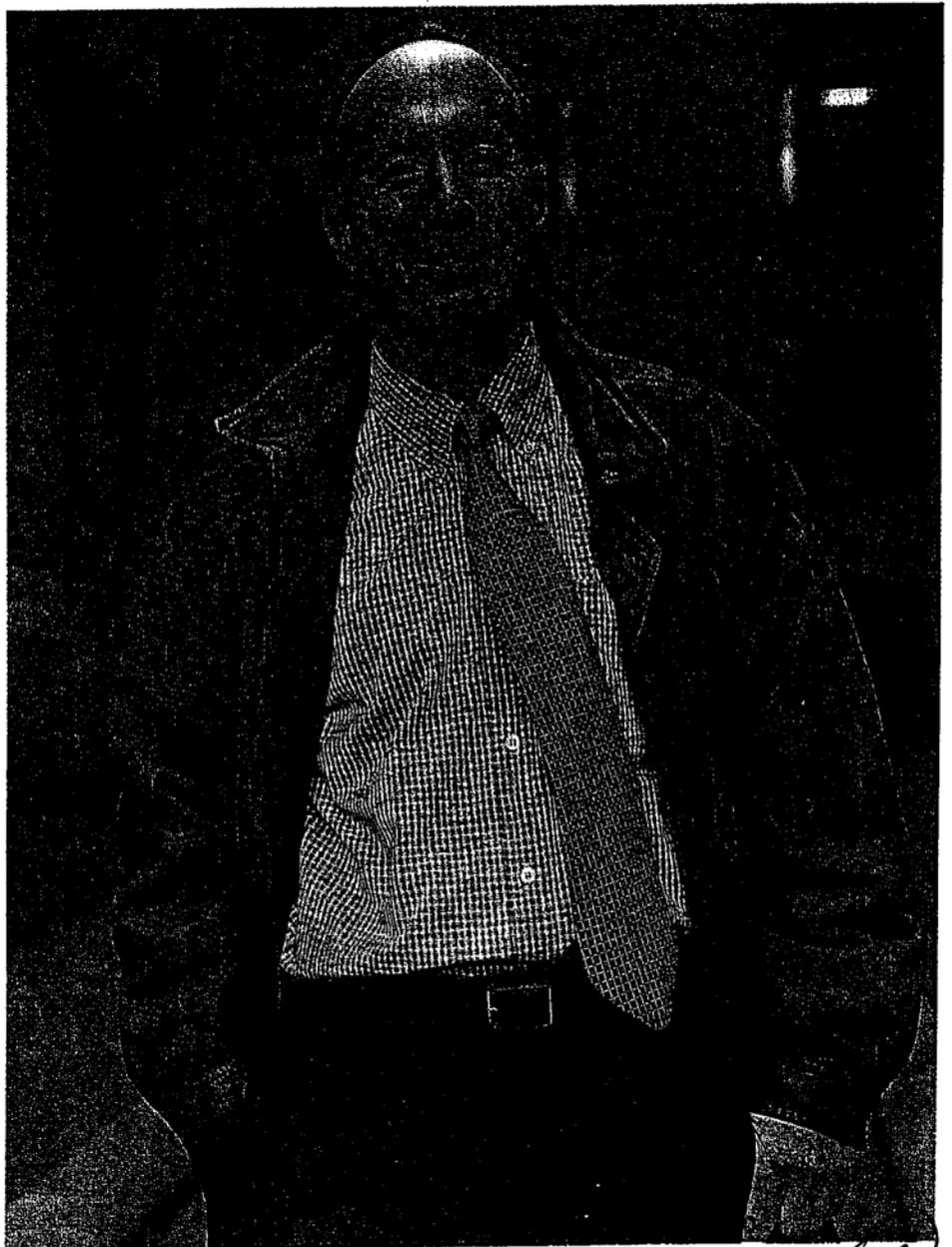
# The \$44 Trillion ABYSS

The baby-boomers are about to retire, and it's going to cost us—*big*. Here's what the government doesn't want you to know.

BY ANNA BERNASEK

**L**ast fall Paul O'Neill, then Secretary of the Treasury, wanted a simple answer to a thorny question: How prepared was the nation today to pay all its future bills? Two government experts worked for months to calculate the answer. Their findings, which shocked even them, were never published—the Bush administration made sure of that. The reason for the silence was that by the time the two researchers had completed their study, O'Neill had been thrown out of the Treasury and replaced by the more politically astute John Snow. No savvy administration power player would dare point out, right in the middle of tax-cut season, that there was a huge hole in the country's finances—a \$44 trillion hole.

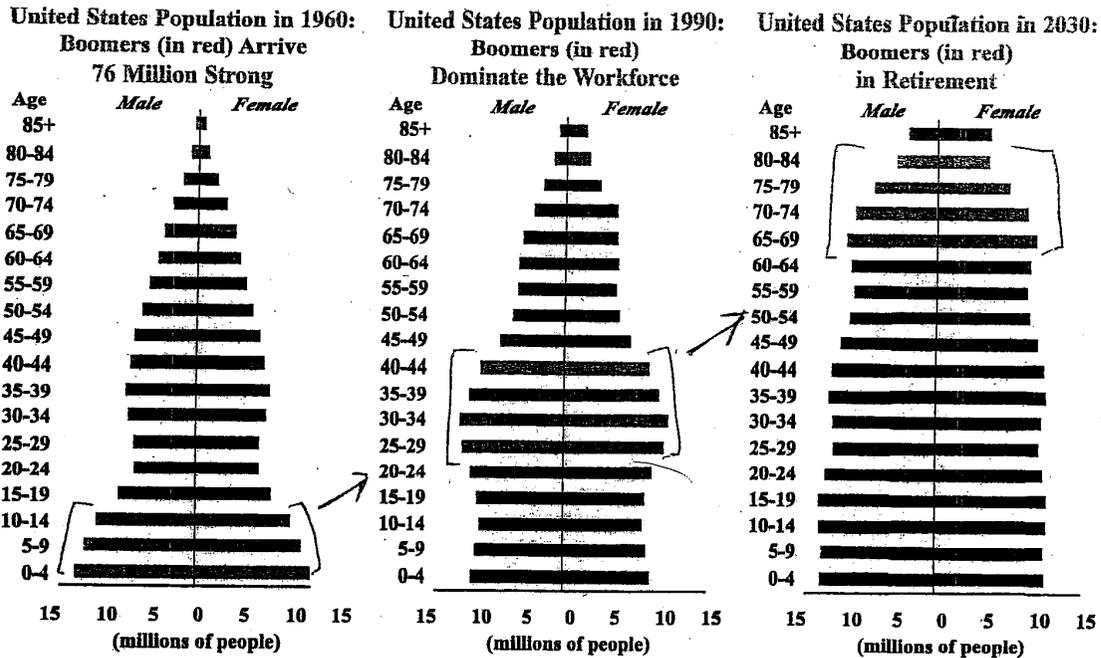
**MAN WITH A MISSION** Boston University's Kotlikoff is a one-man fiscal warning system.



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# U.S. Retirement programs are completely unsustainable

## THE BABY BOOMERS AND THE U.S. POPULATION IN 1960, 1990, 2030



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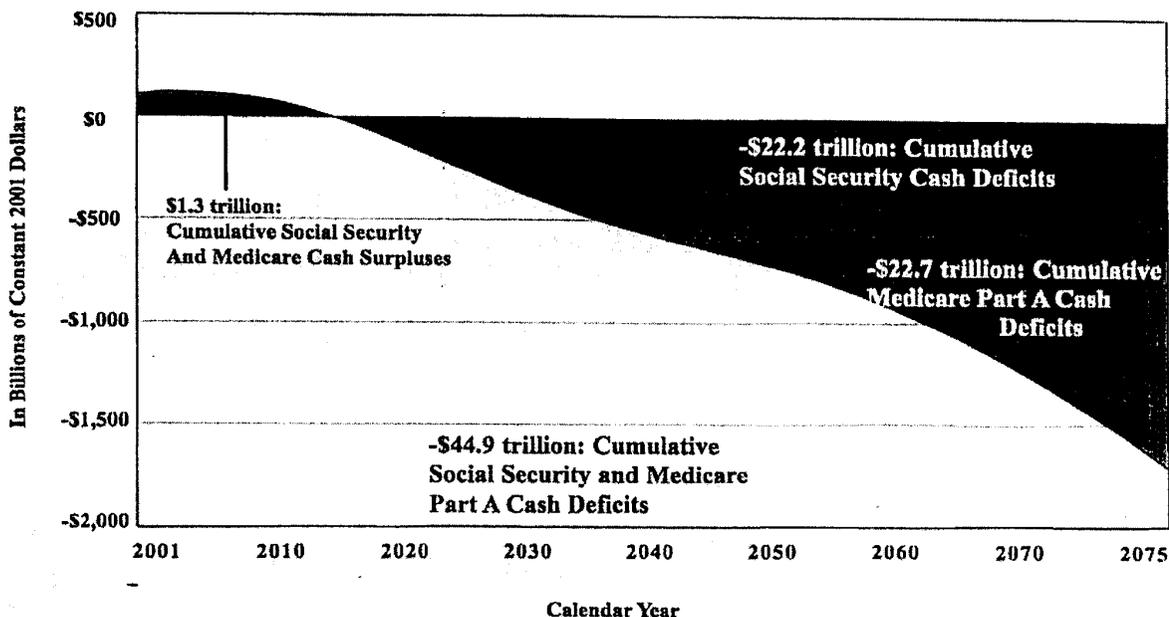
Source: U.S. Census Bureau

AGING POPULATION  
IS THE CULPRIT!

THE CONCORD  
COALITION



## SOCIAL SECURITY AND MEDICARE PART A CUMULATIVE CASH SURPLUSES AND DEFICITS IN CONSTANT 2001 DOLLARS 2001-2075



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Increase the figure by \$7 Trillion for the Prescription Benefit !

"There are tens of trillions of dollars in discounted net present value of commitments and obligations that aren't adequately addressed... We would have to have tens of trillions of dollars invested at Treasury rates today to make good on those promises and we just don't have it..."

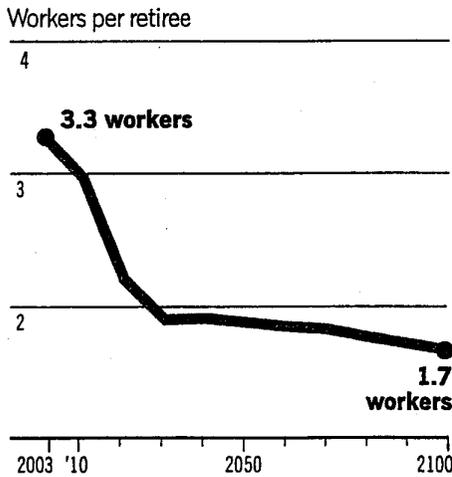
"... We face a demographic tidal wave that is unprecedented in the history of this country..."

Donald Walker, Comptroller General of the United States  
 Fortune, Sept. 10, 2003

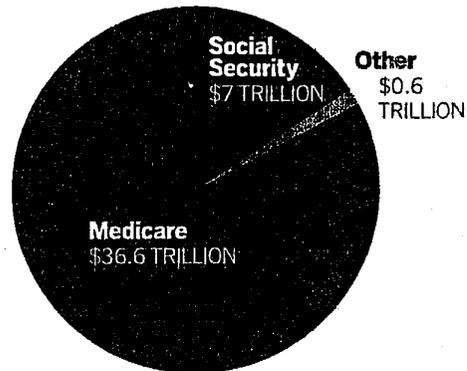
"This particular insurance company [the Federal Government] has made promises to it's policyholders that have a current value \$20 trillion or so in excess of the revenues that it expects to receive..."

Peter Fisher, Treasury Undersecretary for Domestic Finance  
 Wall Street Journal, Jan. 2003

**GULP** The first massive wave of baby-boomer retirees will hit five years from now. That will leave fewer workers to pay for ballooning Social Security and Medicare bills.



How the expected budget shortfall of **\$44.2 TRILLION\*** breaks down

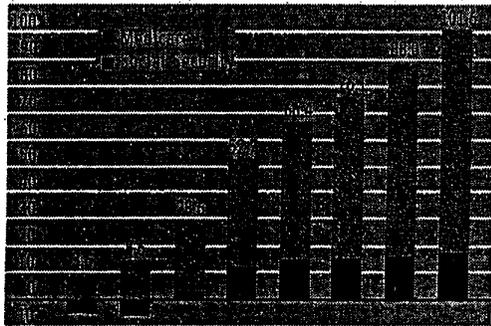


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\*Based on current government revenue and spending.

### Pity the Kids

General Revenue Transfers to Social Security and Medicare as a percentage of income taxes



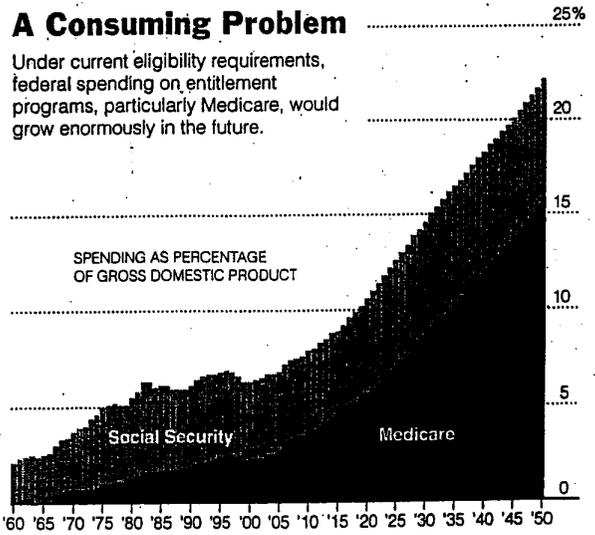
2003 2010 2020 2030 2040 2050 2060 2070

Notes: Federal Income Taxes are estimated to be 10.89% of GDP, which is the 50-year average.

Source: 2004 Social Security and Medicare Trustees Reports and author's estimates.

### A Consuming Problem

Under current eligibility requirements, federal spending on entitlement programs, particularly Medicare, would grow enormously in the future.



Source: Congressional Budget Office

**BBC NEWS**

U.S.  
"FISCAL TSUNAMI"

**David Walker**, U.S. Comptroller General

**Stephen Sackur talks to America's Auditor -in-Chief, David Walker. Is America facing an economic disaster?**

[Click here to watch the full interview](#)

The richest, most powerful nation on earth faces a fiscal "tsunami" which threatens to overwhelm Government and citizens alike.

Who says so? America's auditor in chief, David Walker, whose job it is to oversee all Federal spending.

He's pleading with US politicians and taxpayers to face up to the harsh economic realities that come with an ageing population and spiralling budget deficits.

But is economic disaster really so close at hand?

... **The choices you have to make are exactly opposite to what wins elections...** Leon Panetta

**HARDtalk can be seen on BBC World at 04:30 GMT, 0830 GMT, 1130 GMT, 1530 GMT, 1930 GMT, 0030 GMT**

**It can also be seen on BBC News 24 at 04:30 and 23:30**

*A The American people are going to have to understand where we are, where we're heading, & the consequences of inaction.*

Story from BBC NEWS:  
<http://news.bbc.co.uk/go/pr/fr/-/2/hi/programmes/hardtalk/4857646.stm>

Published: 2006/03/29 13:52:20 GMT

© BBC MMVI

*C Last year's deficit been 500 bn cash but 760 bn accrual.*

*A The choices you have to make are exactly opposite to what wins elections - Leon Panetta*

(12)

*SEE AT : HTTP://www.FullHouseTrader.com/aaii\_presentations.htm*

<http://www.bbc.co.uk/1/hi/programmes/hardtalk/4857646.stm> 2/21/2006

**See 25 minute TV interview with Donald Walker, Comptroller General at: [http://www.FullHouseTrader.com/aaii\\_presentations.htm](http://www.FullHouseTrader.com/aaii_presentations.htm)**

# Deficit looms just when need starts to explode

MEDICAL COSTS SOAR AS FUNDING MUST BE CUT

## HOUSE APPROVES BUDGET CUTBACKS OF \$39.5 BILLION

BY SHERYL GAY STOLBERG

WASHINGTON, Feb. 1 — House Republicans eked out a slim victory on a \$39.5 billion budget-cutting package on Wednesday as a handful of skittish Republicans switched their votes in last-minute opposition to the measure's reductions in spending on health care and student loans.

The vote helped President Bush deliver on his promise to rein in federal spending while underscoring deep anxiety within the party over cutting social welfare programs in an election year.

The measure represents the first major effort by lawmakers since 1997 to cut the growth of so-called entitlement programs, including student loans, crop subsidies and Medicaid, in which spending is determined by eligibility criteria.

It passed 216 to 214, with 13 Republicans voting against. The Senate, with Vice President Dick Cheney casting the decisive vote, had approved the spending cuts in December. The bill now goes to the White House for Mr. Bush's signature.

Coming on the heels of the Tuesday's State of the Union address, the vote was a critical test of Mr. Bush's ability to hold his fractured party together. The House also voted Wednesday to extend the broad anti-terrorism bill known as the USA Patriot Act until March 10, giving House and Senate negotiators time to settle differences on another of Mr. Bush's priorities, a measure to revamp the Patriot Act and make it permanent.

The spending bill, which covers a five-year period ending in 2010, will achieve savings of \$6.4 billion in Medicare, the health care program for the elderly, through a variety of changes that include higher premiums for all beneficiaries, with steeper increases for the more affluent and a freeze in payments to home health care providers. In the Medicaid health care program for the poor and disabled, \$4.8 billion will be saved in part by increasing co-payments and reducing payments for prescription drugs.

After years of cutting into social programs, the budget vote spotlighted how difficult it will be for Mr. Bush to press ahead with even deeper cuts this year. While the bill has strong appeal to the fiscal conserva-

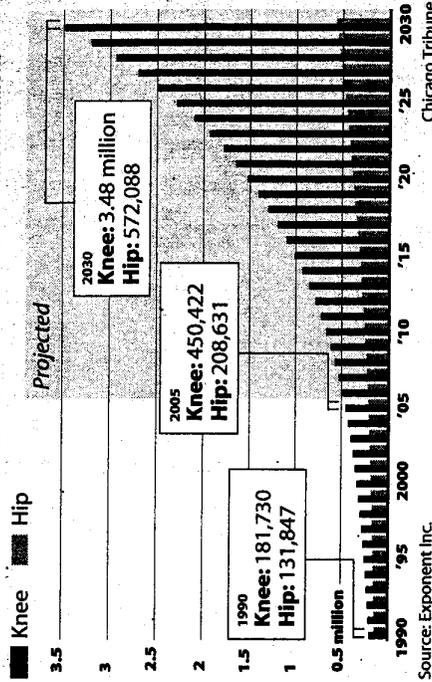
Continued on Page A16

FRIDAY MARCH 24, 2006

### Growing demand

A new study projects a huge increase in the demand for knee-replacement procedures in the years ahead. Hip surgeries are also expected to increase, but not so dramatically.

FIRST-TIME REPLACEMENT SURGERIES IN U.S. Scale in millions



Source: Exponent Inc.

big increase in implants may mean there will not be enough orthopedic surgeons to meet demand unless measures are taken to increase the number of medical school students majoring in orthopedics.

Another concern, Jacobs said, is that after 10 years, 10 percent of the artificial joints had to be replaced. The registry keeps track of all hospitals and surgeons who perform artificial joint implants, and the types of joints they use, to monitor their success and failure rates. Hospitals with higher failure rates receive educational information.

NATION

SECTION 1

CHICAGO TRIBUNE

# New knees, hips are hot

care." son, p and sp iversity ter at care is more, a significant Orth are the erating tals lik significant aid pati a the hos. "Util rupting pected same s loss," H cial join \$30,000 on when "The g not muc effective procedu other ha stantial

osteoarthritis, and improve- ments in artificial joint technol- ogy that dramatically relieve pain and disability, experts say. "A generation ago, when arti- ficial joints were not available, individuals that had joint prob- lems were crippled," said Dr. Joshua J. Jacobs, associate chairman of orthopedic surgery at Rush University Medical Center. "They couldn't partici- pate in the workforce and there was an enormous economic im- pact."

"Now that these artificial joints are available, people can be returned to the workforce and returned to a higher quality of life," said Jacobs, who was not involved in the study. Nine out of 10 people getting an artificial knee replacement report fast pain relief, improved mobility and a better quality of life, according to a 2003 National Institutes of Health report. "Five to 10 years ago, people who got into their 70s would think they were maybe too old

As Americans age, demand for artificial joints expected to soar

By Ronald Kotulak Tribune science reporter

As many Americans live longer and exercise more—and many others become increasingly obese—the number of artificial joints that will be needed to replace damaged knees will jump 673 percent by 2030 to 3.48 million a year, a new study said. The need for artificial hips will climb 174 percent over the same period to 572,000 a year, said Steven M. Kurtz of Exponent Inc., a Philadelphia-based engineering and scientific consulting firm. The study is to be presented Friday at the American Academy of Orthopaedic Surgeons' annual meeting at McCormick Place in Chicago.

The huge increase in arti-

fracture of the hip

SIDE

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washingtonpost.com

## Medicare Will Go Broke By 2018, Trustees Report

By Amy Goldstein  
Washington Post Staff Writer  
Tuesday, May 2, 2006; A03

The financial troubles daunting the Medicare system have deepened during the past year, according to a government forecast that says the federal fund that pays for hospital care for older Americans will become unable to cover all its bills a dozen years from now.

The annual report, issued yesterday by the trustees who monitor the fiscal health of the Medicare and Social Security programs, said the trust fund for the health insurance system for the elderly will run out of money in 2018 -- two years sooner than predicted a year ago and 12 years sooner than had been anticipated when President Bush first took office.

The problem, the report says, has accelerated largely because hospital costs last year were greater than expected.

The forecast also said that Social Security's financial condition has weakened, although its problems are not as great or urgent. It said the retirement system will have enough cash to pay the benefits it owes retirees, disabled workers and workers' survivors until 2040 -- one year less than expected in the 2005 forecast.

In releasing the report, the trustees -- including three of Bush's Cabinet secretaries -- slightly altered the message accompanying the forecast the past few years, when the administration sought to use the predictions as leverage to persuade a reluctant Congress to embrace the president's goal of letting Americans divert some of their payroll taxes into personal retirement accounts. That emphasis prompted Democrats and other critics to chastise the administration for dwelling on Social Security while Medicare's problems were more acute.

Yesterday, the president's aides -- and Bush himself -- drew attention equally to the frailty of the two largest benefits programs that form the twin pillars of the government's assistance to the elderly. The solution, they said, is for Congress to approve changes Bush already has proposed.

Treasury Secretary John W. Snow, one of the trustees, said the programs "form the basis of a looming fiscal crisis for our nation as the baby-boom generation moves into retirement."

"The systems are going broke," Bush said in a health-care speech earlier in the day. "And now is the time to do something about it."

Administration officials portrayed the report as containing some bright news, because spending on the

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# Retiree benefits grow into 'monster'

## Taxpayer burden: \$510,678 a family

By Dennis Cauchon  
USA TODAY

5-25-06

Taxpayers owe more than a half-million dollars per household for financial promises made by government, mostly to cover the cost of retirement benefits for baby boomers, a USA TODAY analysis shows.

Federal, state and local governments have added nearly \$10 trillion to taxpayer liabilities in the past two years, bringing the total of government's unfunded obligations to an unprecedented \$57.8 trillion.

That is the equivalent of a \$510,678 credit card debt for every American household. Payments on this delinquent tax bill must start soon if financial promises to the elderly are to be kept.

The cost of retirement programs will start to soar when baby boomers — 79 million born between 1946 and 1964 — begin collecting Social Security in 2008 and Medicare in 2011.

"This is a monster financial problem that both parties are going to have to solve," says Rep. Jim Cooper, D-Tenn., a member of the House Budget Committee. "Most Americans and Congress members don't realize the terrific burden we are putting on future generations."

USA TODAY compiled a list of all taxpayer liabilities — federal, state and local — to provide a fuller look at the nation's financial condition. The numbers are based on official government reports.

Americans' government obligations are five times what people owe for mortgages, car loans, credit cards and other personal debt. The \$57.8 trillion liability is

### The bill

Taxpayers are responsible for more than \$500,000 per household for unfunded financial promises made by federal, state and local governments. How the debt breaks down:

Program	Liability per household
Medicare	\$263,377
Social Security	\$133,456
Federal debt	\$42,538
Military retirement benefits	\$25,443
State-local debt	\$16,395
Federal employee retirement benefits	\$14,256
State-local retirement benefits	\$13,257
Other federal	\$1,956
<b>Total</b>	<b>\$510,678</b>

Source: USA TODAY research

### S&P WARNING

## Pensions crisis could hit national bonds

By Gillian Tett in London

Large industrialised countries will have their fiscal position cut to "junk" bond levels in the next couple of decades unless they deal with pensions and ageing crises, warned Standard & Poor's, a US credit rating agency.

In particular, the rising cost of social security in countries such as the US, France, Germany, Italy and Japan could push debt to levels normally associated with sub-investment grade or junk ratings without drastic policy change, the agency said.

This scenario is not a prediction but it does reveal the dimension of the task that governments face in pruning benefits granted by unfunded state-run social security systems, the report said.

This gloomy scenario may be hotly disputed by some governments, particularly given that most large western governments are rated by the credit rating agencies — including S&P — at levels well above junk bond status, even for their long-term debt.

S&P said that it assumed most governments would be forced to change their policies to head off the looming crisis, by taking steps such as reducing pension payments.

"Governments do usually react under pressure," said Moritz Kraemer, analyst at S&P.

Nevertheless, Mr Kraemer said the agency had drawn up the scenarios to illustrate the dramatic scale of the "pressures" being created by the global ageing phenomena — and to show that the impact of these pressures could hit countries very differently in the next decade.

According to the agency's calculations, the global old-age dependency ratio — or the proportion of people aged 65 compared to those of working age — will rise from 11 per cent in 2000 to 25 per cent in 2050. In a typical country this would push the national budget deficit to 4

BABY-BOOM DAY OF RECKONING NOT GOING AWAY

S+P WARNS

E23