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Eternal Vigilance

How Iceland's Government made one of History's Most Devastatingly Common Mistakes

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Dear A-Letter Reader,

There's a good chance that you've already heard more about Iceland in the last few weeks & months than you ever have before. In fact, you probably didn't react much to yesterday's news that the government toppled under the weight of the country's financial collapse.

And why should you? The island's only home to 300,000 people - less than Wichita Kansas - and it's historically a backwater of Western Europe. So why would you really care about what's going on in Iceland?

Because it's a perfect example of how governments trade their own sovereignty for prosperity. And how people become complacent with this trade until they've lost both.

Today we're going to look back at Iceland...how it transformed from a handful of fishing villages into a financial metropolis...and how the same forces feeding that transformation led to the country's inevitable downfall.

All Thanks to One Man...

Meet David Oddsson.

Don't be fooled by the funny name and hair, this intrepid Icelander is a



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singlehandedly responsible for the regulatory and legislative changes that fostered the country's frenzied, bubble-based economy.

An actor, writer and radio show producer by trade, Oddsson ascended into the realm of politics when he became mayor of Reykjavik. He then went on to become the country's longest-standing prime minister, from 1991 - 2004, before taking on a role as chairman of the board of governors at the Central Bank of Iceland in 2005.

Before Oddsson took office, as we mentioned before, Iceland was a backwater country. With less than half a million citizens and an economy based on the boom and bust of the fishing cycle, Iceland was one of Europe's poorest countries.

Oddsson vowed to change all that, to free the small country from the vagaries of the fishing cycle and the tyranny of a state-run commercial banking sector. "The crucial factor," he said in a 2004 speech, "was the iron grip that the Icelandic state had on all business activity through its ownership of the commercial banks."

And free them from that "iron grip" he did. Oddsson sold off all the country's commercial banks.

Icelanders savored the change. High interest rates brought boatloads of foreign money into the tiny island economy, and the highly educated locals put it to good use. They built a world-renowned network of alternative energy sources. New biotech and software companies started popping up, and existing companies became more competitive.

But the banks were where the real innovation happened. In 2000, Kaupthing (Iceland's biggest bank) had a total of 208 billion kronur in assets. By the end of June 2008, that figured had ballooned 30 *times over* to 6.6 trillion kronur. That the total assets of the country's three banks were equivalent to ten times the country's GDP only started to seem unnerving *after* the country started to sink.

Icelanders were also eager to embrace a more "American" kind of change. Flat-screen TV's, blue jeans and T-shirts all made their way en masse onto the tiny island. Consumers proved themselves ready and willing to keep their habits in step with the country's rapidly growing economy.

And it was a paradise...while it lasted. Since 2000, Iceland's repeatedly topped the list in several categories. From having the highest standard of living in the world to being the world's fifth-richest nation *per capita* - according to the OECD - few could've imagined that Iceland, darling of the bubble, could fall so hard and so fast.

But it Did.

And after ten whirlwind days, Icelanders stood aghast at the wreckage.

A currency worth half of what it was worth just the other day. A bombed-out stock market that lost approximately 90% of its value in a matter of days. Three insolvent banks and an anticipated 10% decline in GDP over the course of 2009. To make things worse, the country's fish harvest was seriously impaired by a virus infecting over half of the herring catch.

Here's the part where the Icelanders get angry.

The normally conservative and highly restrained Icelanders marched in protest. They gathered in town halls for cathartic meetings where they issued a call-to-action to the media. Protests turned into angry demonstrations...a serious development for the even-tempered Icelanders. The government responded to the rapidly deteriorating situation by stepping down and organizing interim elections for this May.

...History Repeating...

But where were the contrarians? Where were the cynics and the skeptics? Didn't anyone wonder where all that money was coming from? Didn't anyone wonder what had really changed, what justified all the flat-screen TV's and foreign money?

Someone certainly did. But the problem here is that so many people enjoy having more money and more stuff. It might sound overly simplistic, but it's the unfortunate truth the world over. People tend to get complacent when the going is good. Any skeptic, anyone doubting Iceland's meteoric rise would've been challenging the optimism and dreams of the entire nation. In the US, such a skeptic might've been called "unpatriotic."

But there's something deeper going on here. History's most devastatingly common mistake; Iceland traded its own

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sovereignty for the short-term prosperity of its people and its country. Sure, foreign investment is good, and Iceland's central bank was playing many of the same games played by other emerging market economies. But when bank assets outnumber GDP ten times over, a government is clearly powerless to exercise its sovereignty over its own financial system.

Indeed, the proximate cause of Iceland's swift catastrophe was a bailout payment intended to save one of those very banks. And the current government is stepping down not only because of humiliation over its role in the financial crisis, but as an admission that they're incapable of slowing the inevitable decline that Iceland will see in 2009.

Sovereignty - be it National or Personal - is an almost invaluable asset, one whose importance Icelanders didn't realize until it was entirely too late.

Today, the greatest nations in the world - home to the world's largest economies - battle what is becoming one of history's largest economic crises. Their victory or failure will be determined in large part by whether they have maintained enough sovereignty to truly exercise control over their realm. Unfortunately, like in Iceland, it may be all too late before they realize that they've traded that sovereignty away.

In light of that fact, we're going to spend the next few days looking at these economies - in the US, Germany, China and Japan - with a focus on *how* the government is dealing with the global slowdown and crisis. Perhaps in looking at the issue from the perspective of sovereignty, we'll better understand the health and welfare of these economies, and the likelihood that they'll emerge from this crisis at the head of the pack.

Special Offer

\$592 Trillion Phantom Economy Blows as Latest Demon Derivative Unwinds

The worst demon derivative to date is about to whip down Wall Street, leveling what little is left! Over 700 banks (with *trillions* of dollars in assets) will come crashing to the ground. Hundreds of hedge funds will collapse. Corporate bankruptcies will soar. And another \$20 trillion will be wiped off global stock markets. But this one bombed out investment will soar ***two to ten fold*** as the world comes undone. Find out the entire story from the investment group who eerily predicted the current crisis "to a T!"

[Click here to learn more.](#)

Where in the World is Erika Nolan?

The events of the last year have rocked the world's financial system from top to bottom. Not just the major players, like the American banking titans now under the specter of nationalization, but virtually every bank and financial institution in the world. So how are popular offshore jurisdictions and private foreign banks faring amid the chaos?

Our Publisher and Sovereign Society Executive Director Erika Nolan is making a special trip to Vienna, Austria and Zurich, Switzerland to get the answers firsthand...

"We are staying at the Hotel Imperial in Vienna, one of the finest hotels in the country, if not the world. The hotel was originally a palace built in 1863 for the Prince of Wurttemberg. It became the Hotel Imperial in 1873. So after 10 hours of flying and a short cab ride, it was a relief to arrive at such a grand hotel."

"My colleagues are Irish so we headed off to a local Irish pub a few blocks from the hotel for a pint of Guinness. We couldn't help but talk about the drastic and painful changes taking place in that country. From the Celtic Tiger I remember from my days of living in Waterford, it has now become tame house cat...at best. Housing write-downs in Ireland are estimated to be between 50 - 80%. And, the country



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has officially entered a recession...with the construction industry all but finished and the jobs it created, dried up. Unemployment could skyrocket soon. But, this is a familiar scene in many countries."

"Austria is surviving but our friends say that commercial banks here have yet to come clean about the bad property debt on their books. They will likely have to make it public soon. They believe the government will have to step in to rescue its flagship banks when the news - and the write-offs - are announced. Apparently, we are all in this mess together."

"Banking was not the best business to be in the last few months", our friend joked. "But thankfully, private banking has survived." The private banks didn't have the credit exposure of the commercial banks, but their balance sheets were impacted by the negative downturn in the investment markets. Yet, taken side by side, the investment losses can be accepted. Client deposits are still safe, most private banks have more than enough liquidity and they had no risky loans on the books."

"My colleagues saw their bank deposits stay stable in the past few months."

"This morning, we are off to a formal meeting with the bankers, including their CEO. I'm interested to look at their numbers and hear their plans for this year. More on that tomorrow...for now, I'm focused on squeezing in breakfast in the formal dining room. According to our hosts, breakfast at this hotel is quite something and they are expecting a full report."

Erratum: Interest Rate Risk

In our rush to deliver a timely A-Letter yesterday, it seems that we made a minor mistake in calculation that led to a gross underestimation of interest rate risk.

We were looking at a hypothetical scenario where long-term interest rates were zero and the interest rate increased to 1%. In that scenario, we stated that a 1% increase in the interest would wipe out 1% of your original investment in the zero-coupon bond. This calculation did *not* account for the compounding of interest over the lifetime of the bond.

In reality, a 1% increase in interest from zero would effectively bring the value of your 30-year zero coupon bond down by about 26%. And it's also worth noting that the closer long-term rates get to zero, the greater the interest rate risk.

For example, if long-term rates increased from 3% to 4%, you would only be losing about 18% of your initial investment. But with the same 1% difference from zero to one, your bond actually loses 26% of the initial investment.

But this doesn't change our perspective as it was stated yesterday. If anything, it further edifies our position. As long-term rates approach zero, the consequences of interest rate risk increase but the overall reward (return) is worth less and less. At this point, the reward just doesn't seem to justify the risk. Short-term Treasuries, gold or Investment-grade corporate debt are still great alternatives.

President Obama's already hard at work. After pledging to shut down Guantanamo and chastising John Thain for his irresponsible spending, Obama's aides today talked the high-flying execs at Citigroup out of purchasing a US\$50 million corporate jet.

We here at The Sovereign Society are waiting and wondering to see if and when Obama will level his sites on the world of offshore banking. But what if you're new to the party? Do you know about all the advantages of Offshore Banking? Or does the term conjure images of spy movies...of James Bond and numbered accounts, or big corporations' offshore accounts in the Caymans?

If so, then today's Special Comment is for you. Legal Counsel and Resident Offshore Expert Bob Bauman explains the very real benefits and peace-of-mind you can get with an offshore account...

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Yours in Personal Sovereignty,
MATTHEW COLLINS, A-Letter Editor

Special Offer

A World of Secret Possibilities, Financial Freedom and Excited Luxury Awaits You

The face of America is shifting as the economy weakens. The days of prosperity and envy are long gone and it's time to make a choice - live the life of your dreams or let your retirement and investment portfolio sink when things get worse.

You could be spending your days exploring uncrowded, unspoiled Caribbean hideaways before heading back to your beachfront home or enjoying the crisp morning air as you sip a cup of joe from the balcony of your cottage overlooking the Alps...

But you don't need to expatriate to save yourself and your family - I have an easier and more affordable way...

[Please click here to learn how.](#)

Save Your Self and Your Cash - Bank Offshore Now

By Bob Bauman

From the front page of this morning's *New York Times*: "Only five days into the Obama presidency, members of the new administration and Democratic leaders in Congress are already dancing around one of the most politically delicate questions about the financial bailout: Is the president prepared to nationalize a huge swath of the nation's banking system?"

✘ Eric Roseman



To a large degree, the answer is that, thanks to George Bush, the last Democrat Congress and President Obama, billion dollar bailouts have already made banks wards of the U.S. government, feeding off taxpayer funds.

American taxpayers are now the biggest shareholders in Bank of America, with about 6% of the stock, and in Citigroup, with 7.8%. But the government's influence is far larger than those numbers suggest, because it has guaranteed to absorb the losses of some of the two banks' most toxic assets, a figure that could run into the hundreds of billions of dollars.

And already the government as quasi-owner has begun the political meddling I predicted only last week when I said: "Fast forward to the future day when Obama's regulatory bureaucrats will be telling banks where to put millions, to

whom to make loans, who gets mortgages - and who doesn't."

After I wrote that *The Wall Street Journal* detailed how U.S. Rep. Barney Frank (D-MA), the godfather of the FannieMae and FreddieMac subprime housing mess, personally intervened to get some of the bailout billions for a failing bank in Massachusetts.

Plain Folks Intelligence

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My fellow Marylander, *The Baltimore Sun's* acerbic columnist, the late H.L. Mencken, observed: "No one in this world, so far as I know, has ever lost money by underestimating the intelligence of the great masses of the plain people."

But what happens when that great mass of people is gripped by an almost irrational fear, as it appears Americans are today? In 1757, one of my heroes, Edmund Burke, wrote: "No passion so effectively robs the mind of all its powers of acting and reasoning as fear."

Senator John McCain was pilloried by Barack Obama during the 2008 campaign for making the truthful statement that the fundamentals of the American economy were sound, as they still are now.

Yet in his Inaugural Address the new, perhaps chastened, President Obama, referring to "this winter of our hardship," gave his revised estimate that: "We remain the most prosperous, powerful nation on Earth. Our workers are no less productive than when this crisis began. Our minds are no less inventive, our goods and services no less needed than they were last week or last month or last year. Our capacity remains undiminished."

Danger to Liberty

The problems of American banks are real and of their own making. And some of this fear is well placed.



Now the entire world knows the stories of stupidity, excess and greed that brought Wall Street to its knees. President Thomas Jefferson, (who died in near personal bankruptcy), may have approached the truth in a statement attributed to him: "I believe that banking institutions are more dangerous to our liberties than standing armies."

That certainly is true when greedy dunces oblivious to the laws of mathematics and ethics manage banks. And it won't get any better if politicians and government bureaucrats are attempting to manage what remains of American banks.

Offshore Trend

In the last several months we have been deluged by Sovereign Society members (old and new) seeking information about offshore bank accounts - how to set them up, where to get them, how they operate, what the reporting requirements are.

Since our founding over a decade ago, The Sovereign Society has provided international banking guides for members. Drawing on years of experience, we recommend selected banks in jurisdictions where friendly governments welcome foreign financial investors, where banking institutions provide the savvy services investors require. These banks range from Panama to Switzerland and Austria, to Singapore and Hong Kong.

It is our job to explain the positive benefits of having an offshore bank account. Based on each individual's unique needs, we direct members to the right bank in the right jurisdiction, sound institutions where you can protect your assets and manage your wealth.

Continuing Due Diligence

Safety and stability, adequate capital, a good track record, professional, experienced leadership - all of these are factors we consider when recommending offshore banks. Indeed this sort of due diligence is a continuous work on our part.



Even as you read this, our executive director, Erika Nolan, is in Europe meeting with bankers and financial advisors in Zurich and Vienna. The goal is to determine new banking possibilities and reaffirm existing associations, with banks that we and you can, indeed, bank on.

Each of these banks is financially stable, offering modern facilities, services and the necessary understanding to serve an international clientele effectively. The banks we choose have liquidity ratings well above the international minimums set by the Bank for International Settlements in Basel, Switzerland.

Added Protection

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And going offshore adds a strong layer of protection and can be done in more ways beyond banking.



Whether it's in a Swiss or Liechtenstein life insurance wrapper, retirement annuity or an Isle of Man or Panama asset protection trust, placing your assets offshore puts them out of reach of frivolous lawsuits. Litigants usually are ready to settle for pennies on the dollar when they find out how difficult it is to locate and collect your money offshore.

And if you place your 401k or other retirement plan in a suitable offshore jurisdiction - Liechtenstein or Switzerland, for instance - it can be configured to be essentially judgment proof, plus it is covered by strict financial privacy laws that are non-existent in the United States.

Join Us

Americans are now caught in a financial twilight zone, especially as it pertains to banks. For your own sake, we urge you to [join the Sovereign Society](#) today and open the door to safe and secure offshore banking - while you still can. We welcome you. You can bank on it.

Wanted:

America's Next Great Financial Newsletter Writers:

We're looking for serious and sharp analysts in the equity and currency markets to join our growing team of global investment writers. You must have a track record of risk-averse, profitable investing and you must be able to write personally & engagingly. Competitive compensation, unlimited advancement potential and a relaxed and creative work environment all await in Sunny South Florida. Send an email to starfinancialwriter@sovereignsociety.com for details.

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