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Dear Clients and Friends:

I know what you're thinking. Another letter from Gary Shilling warning of the dangers of deflation in the coming recession. But this time I'm going to make it fun. Enclosed with my compliments and best wishes for a Merry Christmas and a Happy New Year is *The Deflation Game*.

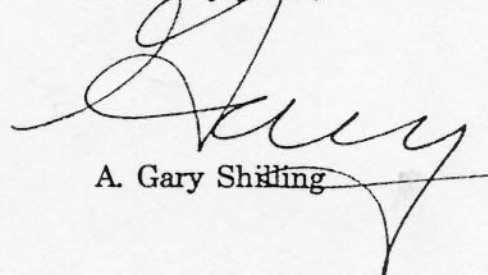
The strategies for winning this game are much the same as you have heard me recommending for some time -- anticipating a change in the inflation climate. If you buy tangible assets watch out -- their value will erode during the game. Load up on financial assets instead and watch your net worth grow. Every time a player lands on a "Price Change" square, prices will change, and two times out of three the change will be down. (Just to keep you on your toes, they'll go up that third time.)

Draw a "Speculation" card and you'll leave yourself open to all manner of financial upset. The 20% yield on those junk bonds looked like a steal at the time, but unfortunately it wasn't clear who was stealing from whom. The company declared bankruptcy and you receive five cents on the dollar. Or that Park Avenue condo you thought would appreciate forever goes in the tank when crack dealers move into the penthouse and panhandlers take up residence on the sidewalk. But draw a "Sound Advice from Shilling & Co." card and you can do something to improve your financial position -- maybe buy that Bottom-Line Growth Stock that we have been recommending and watch it grow in price.

That's the way it goes when you play *The Deflation Game*. It won't make you a fortune in the stock market but it could help take the chill off those cold winter nights when you're long mozzarella futures and the Surgeon General releases a report linking heart failure to pizza consumption.

Although we developed the game initially to give clients and friends like you a few chuckles, it is available to the general public for \$24.95. If you would like another game or two, they're yours with our compliments. If you would like copies of the game in quantity, give us a call.

Sincerely yours,



A. Gary Shilling

Any player may go into debt at his discretion after he throws the dice on his turn. Loans may be taken out only in \$50,000 increments, i.e., \$50,000, \$100,000, \$150,000, etc. When a player goes into debt, he receives bills in the amount of the loan from the bank and places them with the rest of his cash to use as he pleases. He also receives the same amount again from the bank and places the bills upside down in front of him to keep track of the amount of his debt.

PAYING INTEREST WHILE PASSING START

When passing or landing on START, players must make interest payments of 10% on their current debt.

SELLING ASSETS

Assets may be sold under the following conditions:

1. A Speculation card is drawn allowing such a sale.
2. A Sound Advice card is chosen allowing such a sale.
3. Before a player throws the dice on his turn, he may sell any of his assets to any other player who freely agrees to buy, at whatever price the two agree on.
4. When landing on a Liquidation square (see "Liquidation" section above).
5. When a player has run out of cash, reached his debt limit, and still does not have enough money to make a mandatory purchase or payment, he must sell an asset to the bank at current market value (face value shown on the Asset card plus or minus accumulated price chits), minus one more price change chit. Thus, if he has the Old Master Painting with two minus chits, he takes the face value (\$400,000), subtracts the two price change chits (= \$320,000), and then subtracts one more chit since this is a forced liquidation (= \$280,000).

The player must sell the asset with the lowest face value (the price printed in the middle of the Asset card) first. If this still does not yield enough cash for him to make the necessary payment, he goes on to sell the asset with the next lowest face value, and so on, until the payment or purchase can be made. He may not sell more assets than needed to make the payment or purchase. In the case that a player has two assets that share the same, lowest face value, he may choose which one he wants to sell.

No asset may be sold for the purpose of purchasing financial assets, as this is not a mandatory payment.

After an asset is sold, it is returned to the market to be purchased at face value by the next players landing on the squares as described in the Financial Asset Squares and Tangible Asset Squares sections above.

BANKRUPTCY

A player is bankrupt when he has no more cash, no assets, has reached his debt limit, and still cannot make a mandatory payment or purchase. He is then out of the game.

WINNING

LONG GAME: The game is played out until one player remains after the others have gone bankrupt.

SHORT GAME: The players decide upon some time limit at which to end the game. When it is reached, each player counts up his remaining cash, adds it to the total current market value of his assets, and subtracts his debt. The player with the highest resulting net worth is the winner.

THE DEFLATION GAME

Instructions

GENERAL DESCRIPTION

Players move around the board buying and selling two types of assets: tangible assets such as real estate, wine, and baseball cards; and financial assets such as government bonds, stocks, and CD's. They also make and receive payments on these assets and incur and redeem debt. During the game the inflation environment changes, with prices rising during some periods and declining in others. **ON BALANCE, PRICES ARE DECLINING: THAT IS, THERE IS USUALLY DEFLATION.** Therefore, the game favors those who accumulate financial assets rather than tangibles and stay out of debt.

STARTING THE PLAY

One player is selected as the banker. The banker distributes money to the players as follows:

2-3 players: 5 \$100,000 bills; 5 \$50,000 bills; 5 \$20,000 bills; 10 \$10,000 bills; 10 \$5,000 bills. (Total: \$1 million each)

4-6 players: 4 \$100,000 bills; 3 \$50,000 bills; 5 \$20,000 bills; 5 \$10,000 bills; 10 \$5,000 bills. (Total: \$800,000 each)

Each player selects a playing piece and places it on START. The players then throw the dice in turn and move their pieces around the board clockwise the number of spaces indicated. Doubles do not give a player an extra turn.

FINANCIAL ASSET SQUARES (COLORED GREEN)

When a player lands on a Financial Asset square (green), he may purchase the asset if it is not already owned by another player, but need not.

If he elects to buy, he pays the price shown in the middle of the square to the banker and receives in return a card naming the asset along with its price and the payments other players will pay him when they land on the square. If he does not elect to buy, it is then auctioned off by the banker to the highest bidder amongst the other players, with a minimum bid of face value (the price printed in the middle of the square and card). If there are no bids, the asset remains on the market until the next time it is landed on, when the process is repeated.

If another player owns the financial asset, the player landing on the square makes a payment to the owner in the amount shown in the bottom right-hand corner of the square. If a player already owns the square he lands on himself, nothing is done.

TANGIBLE ASSET SQUARES (COLORED BLUE)

When a player lands on a Tangible Asset square (blue), he must purchase the asset unless it is owned by another player. He pays the price shown in the middle of the square to the banker and receives the corresponding asset card in return.

If another player already owns the asset, the player landing on the square makes a payment to the owner. In inflation (see Price Change section below), this rent payment is in the full amount in the bottom right-hand corner of the square; in deflation, the rent payment is one half this amount, as indicated on the bottom of the card.

If a player landing on a Tangible Asset square already owns the square, nothing is done.

INFLATION/DEFLATION CARD

At the beginning of the game the Inflation/Deflation card is placed in the middle of the board with the word "inflation" face up. The first time a deflationary price change occurs (see Price Change section below), the card is turned over so that the word "deflation" shows. At the next inflationary price change, the card is turned back to show the word "inflation," and so on.

When the word "inflation" faces up, payments are made to owners of tangible assets by other players landing on their squares in the full amount indicated in the bottom right-hand corner of the cards and squares. During deflation, payments are made to tangible asset holders of one half the "inflation" amount, as indicated on the cards. Payments on financial assets do not change, as interest rates are assumed fixed.

PRICE CHANGE SQUARES

When a player lands on a Price Change square, he throws a single die. If he throws a 1, 2, 3, or 4, this means deflation has occurred. If it turns up a 5 or 6, this means inflation has occurred. When deflation occurs, the bank issues to the owners of tangible assets one price change chit with the minus (-) sign face up for each tangible asset. It issues to the owners of financial assets one price change chit with the plus (+) sign face up for each financial asset. The chits are to be placed on the cards.

For every minus or plus chit added to a Financial Asset card, the value of the asset goes up or down by the amount shown in the bottom right-hand corner of the card. For instance, the \$400,000 Old Master Painting card with one minus (-) chit has a market value of \$360,000; the Utilities card with a face value of \$300,000 is worth \$330,000 with one plus (+) chit.

When inflation occurs, the bank issues one plus (+) chit for each tangible asset owned, and one minus (-) chit for each financial asset owned.

As the game proceeds, assets held for a long time will accumulate large numbers of chits. After a long period of sustained inflation or deflation, the value of certain assets may therefore reach 0. In this case they are returned to the banker to be bought at original face value by whoever lands on the square, as indicated in the instructions above.

SPECULATION SQUARES

If a player lands on a Speculation square, he draws one of the Speculation cards and reads it to the other players, who then follow the instructions on the card. Some instructions result in cash gains or losses, which should be taken from or made to the bank. Others result in changes in asset value and should be indicated by the distribution of the appropriate number of chits to the players affected by the cards. This is indicated clearly on each card. If none of the players owns the property referred to on a Speculation card, nothing is done.

Once a card is read, it is replaced under the pack face up. After the pack has been run through once, it is shuffled and replaced face down on the board.

SOUND ADVICE from Shilling & Co. SQUARES

If a player lands on a Sound Advice from Shilling & Co. square, he picks up the entire deck of five cards. Each card suggests a course of action that he may take to improve his position. He may choose any one, but not more than one, of these actions.

Any player landing on the Sound Advice square at any time is free to choose any of the Sound Advice cards; that is, his choice is not limited by what other players have chosen or what he has chosen to do before.

Some of the cards refer to current market value. See Liquidation section below for definition of current market value.

COMMODITY SQUARES

If a player lands on a Commodity square, he need not do anything. However, if he wishes to he may go long the Gold or Pork Belly futures -- that is, he may bet that Gold or Pork Belly prices will rise. In order to do so, he first must decide how many futures contracts he wishes to play, with a minimum of one and a maximum of six. For each contract bought, he stands to make or to lose \$100,000. For instance, if he says he will buy four contracts, he will wind up making or losing \$400,000. He may buy any number of contracts up to six regardless of how much cash he has or the worth of his assets.

Once he has decided how much to risk, the player throws a single die. If he throws a 1, 2, 3, or 4, this means deflation has occurred; he loses, and pays his money to the bank. A throw of 5 or 6 means inflation; he wins, and receives his money from the bank. Prices of other assets on the board are affected as in the Price Change section above -- flip the Inflation/Deflation card accordingly.

Although the odds are obviously against winning on the Commodity square, the amounts of money involved are large enough to turn the game around if a player wins. Hence, this square is probably best used toward the end of the game when a trailing player wishes to take a chance to put himself back in the running.

LIQUIDATION SQUARE

When a player lands on a Liquidation square, he must liquidate one tangible asset, of his choice, at half its current market value. If he owns no tangibles, he does nothing.

Current market value is the price shown in the center of the Asset card plus or minus the price change chits that the card has accumulated. For instance, over time the owner of the Old Master Painting might have accumulated 2 minus chits. To get current market value, he first subtracts the chits: (\$400,000 - \$40,000 = \$360,000; \$360,000 - \$40,000 = \$320,000). \$320,000 is the current market value. He then divides that amount (\$320,000) by 2 to get \$160,000, the liquidation price.

Following liquidation, the property is considered available again and must be bought at the face value shown in the middle of the square by the first person to land on it.

DEBT

Each player starts with the following credit line:

2-3 players	\$500,000
4-6 players	\$300,000