

## The End of the US Dollar?

### Purpose

*This is a reissue of previously disseminated information.*

The *CJ* Investment Newsletter deals with the entire spectrum of securities investing, including cash (money market funds), bonds, equities and options. It will evaluate the overall investing environment and then discuss the relative allocations of these asset types, as well as strategies to implement within them. Essentially, it reflects what I'm actually doing with my clients.

These letters are not sent "cold." Either I know you or someone you know gave me your name. Yes, this letter *is* a sales tool. It communicates how I apply my investment strategies, so that you can decide, without any sales pressure, if my thinking is compatible with how you want your money invested. If you're not already a client, I would like to discuss your *becoming* a client. Please call me for more information.

However, that's not its only purpose. Even if you never become a client, if you want this information, I want you to have it – for a while, anyway. My hope is that providing this information and teaching you what I think is important when investing may help you. Please contact me if you have any questions or comments. I'd love to hear your reaction to my letter.

### Quick Look

#### Market



#### Next Expected Move



- Major indices are in trading ranges. Will the breakouts be to the up or down sides?
- The US\$X drops below 80 for the first time this year.
- Gold and Silver had a great run in May as the US\$ loses value.
- Major economic countries make stronger moves towards removing the US\$ as the world's reserve currency.

### The Cost of Using the Printing Press

The Obama administration's approaches to fixing the economic and market declines, including the willing participation of the House and Senate, have been discussed at length earlier this year in the *CJ Newsletters*. Almost one entire issue was devoted to the "Stimulus" package proposed by the Obama administration and enthusiastically embraced and expanded by the Congress.

Even ideologues who believe these programs will (eventually) help the economy realize that taxes

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can't be raised until the economy is solidly into a new expansion phase. Instead, the "support" and "payment" for the new programs (until taxes can be raised enough to actually begin paying for them) consists of the massive creation of US\$ out of thin air by the Fed.

Basically, the Treasury issues debt to raise US\$, which the Fed monetizes by purchasing the Treasury debt and issuing US\$ to the Treasury to "pay" for them. In this way, the Fed provides US\$ for the Treasury to meet the US government's debts. If the Fed buys enough debt of any kind, it lowers the overnight interest rate and eases credit by expanding the money supply.

Sounds great, right? What's the problem?

Most people think of money as wealth because of its function as a medium of exchange. Naively, we also tend to believe that a US\$ is a relatively unchanging measure of value. Both CAN be true, but not for the US\$ because of the way the US government has treated our money for longer than my 56 years of life.

How much sense does it make to assume the US\$ will maintain its value when we create US\$ out of thin air as described above? In the past, I've used a balancing scale to explain how the US\$ is valued and what inflation is. Let's go a different direction this month.

At any point in time, the US collectively owns a finite amount of tangible and intangible wealth. This is axiomatic. *One US\$ is exactly equal to that finite amount of wealth divided by the money supply.* Of course, there are many measures of the money supply, so the value of the US\$ will change based upon which measure is used. One principle remains steadfast, however: *If the US\$ money supply grows faster than the collective US wealth, the US\$ will become worth less – and, eventually, worthless.*

This is what is called inflation, which is based upon the expansion (inflation) of the money supply. The effect of inflation is the cheapening of the US\$, which is why, eventually, almost everything will cost more in US\$ during an inflationary period.

Keep in mind that, in our system, only our central bank (the Fed) can expand the money supply. In fact, *inflation is always and forever a phenomenon that requires a central banking system.* Inflation is used by our Fed and Treasury as a means to finance US government deficit spending. The greater the deficit,

the higher the combination of taxes collected and inflation created must be to finance the deficit.

In the future, despite what the government says, higher taxes are coming for everyone. Even the rich aren't rich enough to pay for this government's largess. Either taxes will be massively raised on the ENTIRE US population or the US\$ will collapse and vanish into history with all the other fiat currencies in history's dustbins. Eventually, the government debts must be paid for by real *wealth*, not worthless Federal Reserve Notes (US\$). The disruption caused by the latter scenario could threaten the very existence of the United States as a country.

The Nash equilibrium first laid out by the brilliant Stephen Roach, described in the 6/06 *CJ Newsletter* and excerpted in my article in the 6/27/2006 *Kansas City Star* is finally breaking down. The US\$ is being destroyed so forcefully by our current government that the world's strongest economic players, especially China and Brazil, are moving to replace the US\$ as the world's reserve currency.

Having the US\$ as the world's reserve currency imparts a tremendous advantage to our economy other countries don't have. In effect, it has allowed us to devalue our currency for decades while our trading partners (creditors) have shouldered the brunt of the devaluation of the US\$. It has allowed us to create US\$ out of thin air without apparent loss to our economy.

Our trading partners, especially China, were concerned during the Bush administration, but stayed their hands because they believed they were still better off to incur some losses on their US\$ reserves and continue to sell to us (the Nash equilibrium) than to divest themselves of US\$ and risk massive losses to their US\$ reserves or, worse, the total collapse of the US\$.

The Obama administration, Treasury Secretary Geithner and Fed Chairman Bernanke embarked on the most aggressive spending program in the history of the US (by at least a factor of 4) within months of taking power. This is particularly funny in light of the enormous criticism heaped upon the Bush administration by the Democrats during election season and after the change of power in 1/09. The funny part is, they were absolutely right to criticize the Bush administration for its profligacy.

To raise the spending bar by a factor of at least 4 and then pretend to be fiscally responsible only serves to

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## Asset Allocation Percentages CJ Current Suggested Ranges

**Dow Theory Market Phase:** BEAR  
**Appropriate Current Allocation:** DEFENSIVE

<u>Asset Class</u>	<u>Conser- vative</u>	<u>Aggres- sive</u>
Money Market Funds	70-10%	55- 5%
<i>Long Positions:</i>		
Bonds & Bond Funds	30-60%	40-60%
RD Stocks	0-10%	0-10%
Growth Stocks	0%	0%
Gold Equities/Funds	0-20%	10-30%
Bear Market Funds	0- 10%	5-20%
<i>Aggressive Positions:</i>		
Shorts and/or Options	0%	0- 5%

### Notes:

Income generating portfolios may not conform to the above guidelines. If income is the primary purpose of a portfolio, income needs are met *first*, then other allocations are made.

Up to 50% of bond/bond fund positions should be in international (non-US) bonds. Such bonds will provide higher interest paid on the face due to the additional *perceived* risk of foreign bonds, as well as providing hedging gains as the dollar declines against foreign currencies due to Fed monetary policies.

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show how “in the tank” the media is for Obama and how woefully ignorant our populace is about economic matters. Ignorant by government decree, as they control the public education system and the government makes little attempt to educate us in economics, let alone the type of economics that does not approve of government interference. After all, an ignorant populace is easier to control.

This is fiscal responsibility? I think not. And, neither do our trading partners, who are now breaking the Nash equilibrium in order to salvage what resources they can before they are stuck with an enormous loss. It’s clear they no longer trust the US to be a responsible trading partner or to be responsible with the value of its own money. Nor should they.

Some telltale signs of change in the value of the US\$ are as follows:

- The US\$X has declined 10.8% from its 3-year high on 3/3/09 and 6.5% in May alone.
- Gold was up 10% in US\$ terms in 5/09.
- Silver was up 26.7% in US\$ in May.

Our trading partners are clearly beginning the process of reducing the amount of their US\$ reserves down to the minimum amount needed to be able to trade with us. “Excess” reserves are beginning to be dumped into the world market, making for a glut of US\$, and, therefore a lower trading value to each US\$. We have no one to blame but ourselves; our previous behavior put them on alert and our current economic behavior has forced their hands.

Is it the beginning of the end for the US\$ and America as we know it? That case could be made. Our current government is highly socialistic and has no real counterbalance from the “loyal opposition,” not that the opposition approach is much healthier for our future. When we replace equal opportunity with equal results, we will all be (with a few political exceptions) the poorer for it. Just as the USSR learned.

All but the truly poor in the US have things even the most powerful never dreamed of 100 years ago. Our “poor” have cars, TV, computers, medical care, healthy and affordable food. Our government’s definition of “poor” must be laughable to other societies that have *real* poverty. They must also wonder why such a wealthy society would turn its back on the things that made it great.

We can only pray that, as they see our way of life decline, our leaders will realize their errors and return to our root beliefs of capitalism and freedom of opportunity. Or, at least that such leaders appear and are voted into office to replace those we now have.

Will the American dollar and the American experiment fade away into history? A socialist America certainly crushes the dream our founders and generations of brave Americans fought and died for – a dream of freedom and the opportunity to work for the improvement of one’s *own* condition, not that of the collective. Equal *opportunity* for all, not equal *results*. I hope and pray that we have merely lost our way for a while, and that the spirit that drew America towards its own goodness and greatness will revive. America has changed the world for the better and saved the world from horrible tyrants thrice. So far, the American spirit has proved occasionally misguided, but an indomitable force for good in the end. Time will tell, but it’s never been smart to bet against us. I’m sure not going to.