Special Update on Current Global Crisis and the Dollar's Recent Strength

Many of the dire predictions that I made earlier in the decade, which at the time were considered wildly pessimistic by the mainstream, have come to pass in spectacular fashion. But while the economy has been contracting, home prices plummeting, mortgage defaults skyrocketing, banks failing, corporate earnings evaporating, and the government implementing an unprecedented binge of monetary expansion, the U.S. dollar has actually put in one of the most furious rallies I have witnessed, rising nearly 30% against many currencies. The perverse reaction makes no fundamental sense, and is simply the result of market panic and yet another failure of investors to see the world as it truly is.

The dollar's sudden surge, no matter how violent, will not last. The minute the dollar stops rising it should completely collapse. The rally is a function of private investors, particulars those using leverage, who are selling everything, including foreign stocks and currencies in order to move to the perceived safety of U.S. Treasury bonds. Once this deleveraging is over, the short-term selling pressure on foreign currencies will disappear. When the foreign exchange markets finally have a chance to digest all that has happened, and all that is likely to happen with respect to bailouts and stimuli, the dollar should fall though the floor for all the fundamental reasons laid out in this report.

It is important to remember that while private investors are currently buying dollars, foreign central banks are not selling. Even as their own currencies collapse, hurting the affluence of their citizens, foreign governments continue to hoard trillions of U.S. dollar reserves. It simply makes no sense that they are not using these dollar reserves to push up the value of their own currencies. Of all the crazy ways governments are intervening to support their markets, this is the one that would make the most sense.

The only possible explanation is that foreign governments still have not figured out the problem, and have continued to peruse monetary policies designed to maintain the "America first" status quo that created the current crisis in the first place. They are so fearful that our debt financed consumer economy will collapse that they are willing to destroy their own economies to prop it up. However, at some point our creditors will finally figure out that the price tag for baling us out is much higher than the cost of letting us fail. When they finally open their eyes, it will not be a pretty picture of the U.S. dollar, or the American economy.

This Special Report explains the core reasons why the dollar must fall markedly in value in the future. The time frame has been pushed back a little, but I believe, now more than ever, that the outlook for the dollar is bleak.

If you have not read either of my books, I urge you to do so. My first book, Crash Proof, was a blockbuster bestseller, and voted one of the 10 best investment books of 2007 by both Kiplinger's and Amazon.com. My second book, just released and already a best seller, was called "a must read…" by Jim Rogers. The books are the #1 and #2 best selling investment books on Amazon.com.

Introduction

In an economic sense, the United States is in uncharted waters. After years of easy monetary policy and illusionary prosperity from excessive debt growth, we are beginning to pay for our past economic sins. A mere glimpse at the headlines today reveals that housing prices are depreciating at a rapid pace, the nation's largest banks are writing off losses by the billions, sovereign wealth funds are buying large stakes in our corporations to keep them afloat, and the credit crunch has severely curtailed access to the credit markets for both individuals and businesses.

Meanwhile, the government continues to spend about $200 billion per year more than it takes in, and the trade deficit is running around $700 billion annually. Inflation and unemployment are heading higher, too. One needs to look no further than rising commodity prices. Crude oil and gold are at all time highs while many core agricultural commodities, such as corn and wheat, are up well over 100% in the last couple of years.

Some in the media like to spin these aforementioned events as unrelated. However, the collapsing US dollar is the root cause of all these moves and in fact, lies at the epicenter of the current turbulence.

In this report, we will first discuss the trouble ahead for the US dollar, and then make the case for investing in non dollar-denominated assets. And finally, we will tell you about the services we offer at Euro Pacific Capital. We will explain how we can help you protect your wealth—and even profit—from the dollar's impending ruin.

The Collapsing Dollar

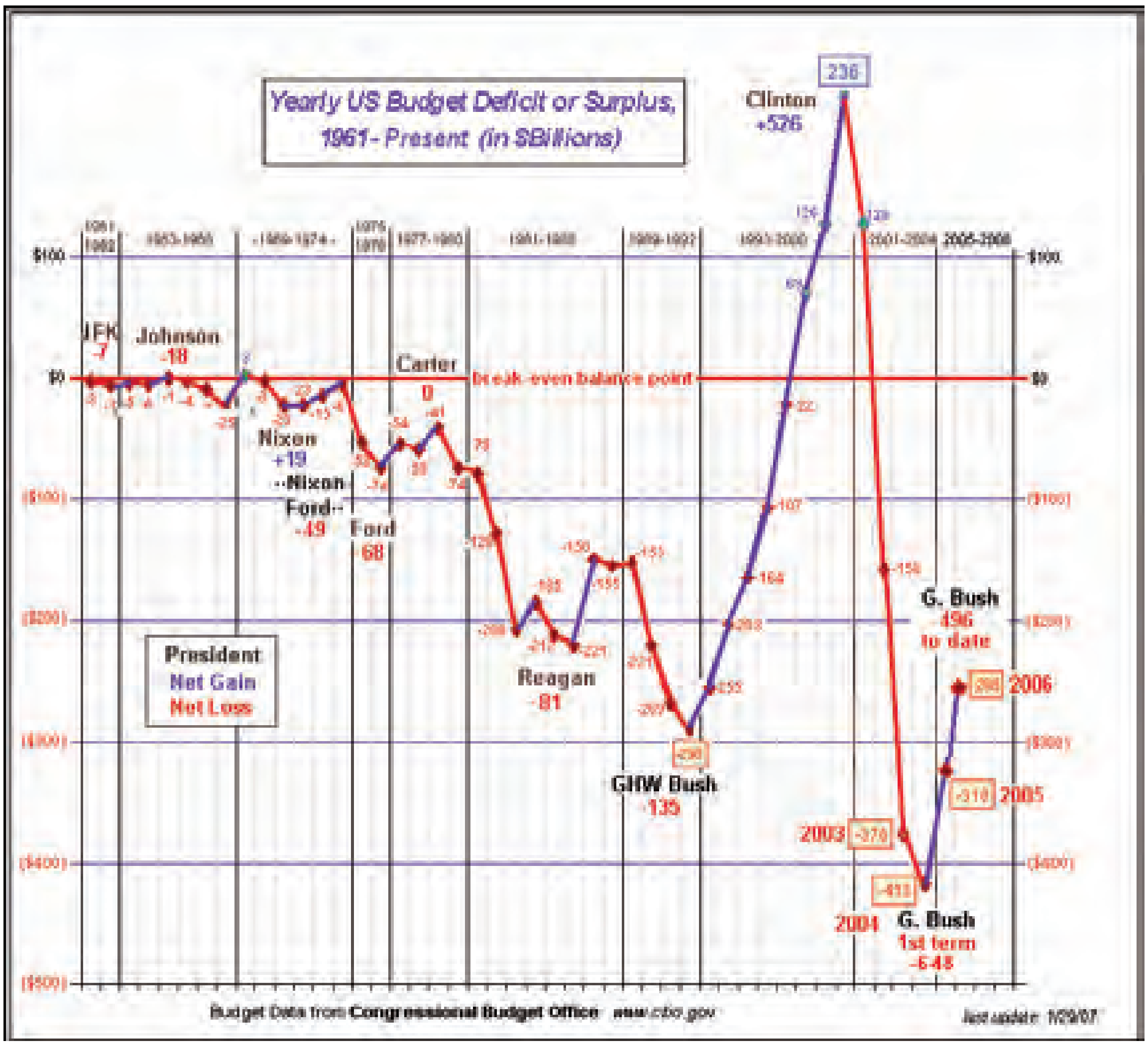
The US dollar's value has declined dramatically in recent years (See Dollar Index Chart below). At the beginning of 1998, the dollar index was around the 100 level. [1] At the time of this writing, ten years later, the index stands at just under 73 – an all time low. This is a decline of over 25%. If you compare the dollar's current level to its recent peak in 2001, the decline would be close to 40%!

Despite the already enormous depreciation in the dollar's value, the currency still has much further to drop. The reason for the continuing decline resides with the fundamentals, which are as negative (if not more so) than at the dollar's 2001 peak. The following paragraphs highlight the five biggest threats to the dollar's stability.

[1] The Dollar Index is a widely used index that measures the United States dollar relative to a basket of foreign currencies. Approximate weightings at the time of writing: 57.6% Euro, 13.6% Yen, 11.9% Sterling, 9.1% Canadian Dollar, 4.2% Swedish Kroner, and 3.6% Swiss Franc.

1. Budget Deficit and National Debt

Budget deficits occur when governments spend more than they receive in revenues. As you can see from the chart below, the US government has run budget deficits for many years, cumulatively fueling an enormous national debt of more than $9.2 trillion. This equates to just over $30,000 in debt for every man woman and child in the country. And that does not even include personal liabilities (mortgage payments, car loans, etc.)!



Although paying down this debt has never been given serious thought in Washington, the interest cost alone is becoming unbearable. In 2006, the government spent $406 billion on debt interest payments, representing the third largest line item in the federal budget, behind defense and social services spending. This is akin to a family only paying the interest on their credit card debt, and never paying down any principal.

Unfortunately, one day the bill will come due. If the hypothetical family decided to pay off their credit card bill after years of accumulated charges, they would need to both work more and limit their spending. The government could mimic these actions by both raising taxes and limiting government services. Both of these options are unpopular for politicians trying to win public support, more so in an election year.

Unlike our hypothetical family, the government, via the Federal Reserve, has the ability to print money out of thin air. Not surprisingly, this is the more politically favorable approach. The unfortunate result is the debasement of all of the dollars already in existence.

> *As Warren Buffett stated at the annual Berkshire Hathaway meeting in May 2006, "The more you owe, the more it becomes attractive to devalue the currency." Unfortunately, our national debt is rising at a rate of over one million dollars per minute, literally making devaluation more attractive by the second*.

2. Ballooning Trade Deficit

A trade deficit occurs when a country imports more than it exports. As the chart below depicts, the United States is running record current account and trade deficits. This means that we are borrowing money from foreigners to pay for foreign goods. This makes little logical sense, and even less economic sense.

As Warren Buffett stated,

> *"The U.S. trade deficit is a bigger threat to the domestic economy than either the federal budget deficit or consumer debt and could lead to political turmoil…Right now, the rest of the world owns $3 trillion more of us than we own of them."*
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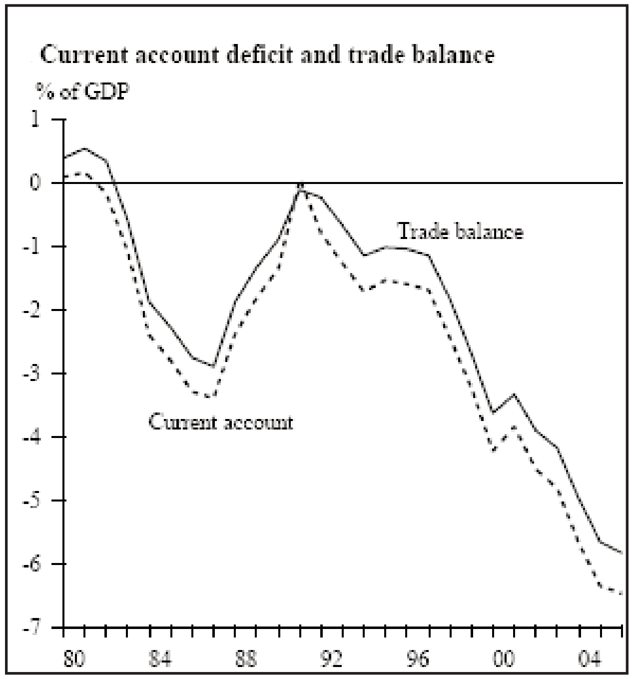
> *Associated Press, January 20, 2006*



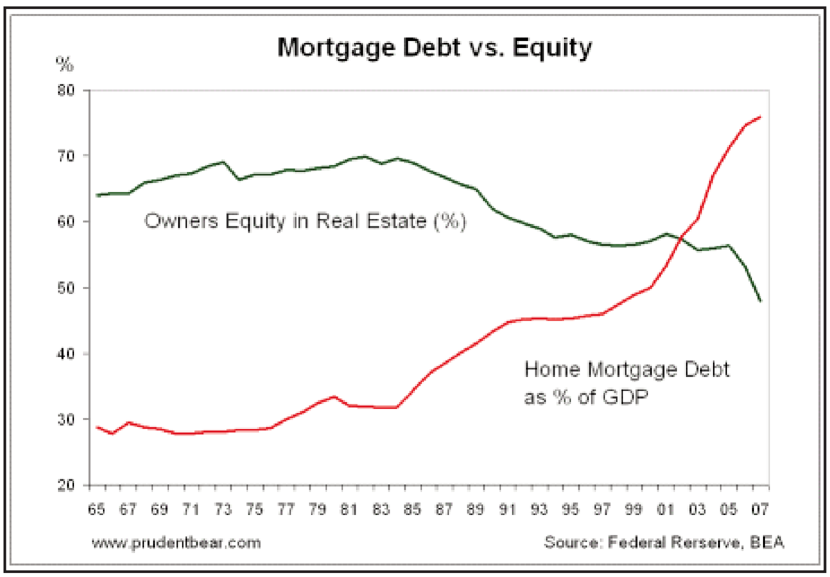
Amazingly, the $3 trillion figure that Buffet spoke of has risen considerably over two years. The fact that the current account deficit and trade balance have not yet significantly contracted despite current dollar weakness indicates that the dollar still has a long way to fall until exchange rates find equilibrium. While the correction process may not go in a straight line, the ballooning trade deficit is a strong long-term trend working against the dollar.

As our creditors wake up to the fact that we are repaying our debts in depreciated dollars, they will likely demand higher rates of interest to compensate for the currency risk. Worse, if our foreign creditors reject the notion of holding our foreign debt and try to liquidate their dollar holdings, the dollar could collapse.

3. The Housing Debacle Is Not Going Away

Despite the headlines about plummeting condo prices in Florida and home builders slashing prices of inventories in California, housing still has a long way to fall.

As the chart below indicates, home mortgage debt as a percentage of GDP is still at record levels. Easy access to credit allowed consumers to take on more debt than they could afford which over-stimulated the housing market resulting in an abnormally high spike in home prices. The combination of artificially high home prices and excessive mortgages (in relation to home value) explains the high default rates today. Once home prices return to historically normal levels, enabling home buyers to finance their purchase without incurring debt that they can ill-afford, the red line should correct.



This chart also shows owner's equity as a percent of home value. Prices must fall significantly for this percentage return to its long-term mean.

Further, the share of U.S. homes owned but empty totaled 2.7 percent at the end of 2007. The historical average is just under 1.5%

As market forces work to make home prices and debt return to normal levels, the Federal Reserve will try to counteract this by lowering interest rates. These actions will lead to higher money supply growth and a weaker dollar.

4. Money Printing at the Federal Reserve

Experience tells us that once market forces are unleashed, efforts to reverse them seldom succeed. Popped bubbles don't reflate. Just as efforts to breathe life back into the tech stock bubble in the early part of this decade led to the creation of the housing bubble, current efforts to stop home prices from falling will produce similarly unintended negative consequences.

> *The Financial Times recently published an article about the Federal Reserve Chairman's objectives.*
> *"In a dramatic change of tone, Ben Bernanke yesterday indicated that the Federal Reserve is ready to cut interest rates aggressively to ward off the risk of a US recession. The Fed chairman said: 'We stand ready to take substantive additional action as needed to support growth and to provide additional insurance against downside risks.' His decisive language…represents a new message from the Fed…"*
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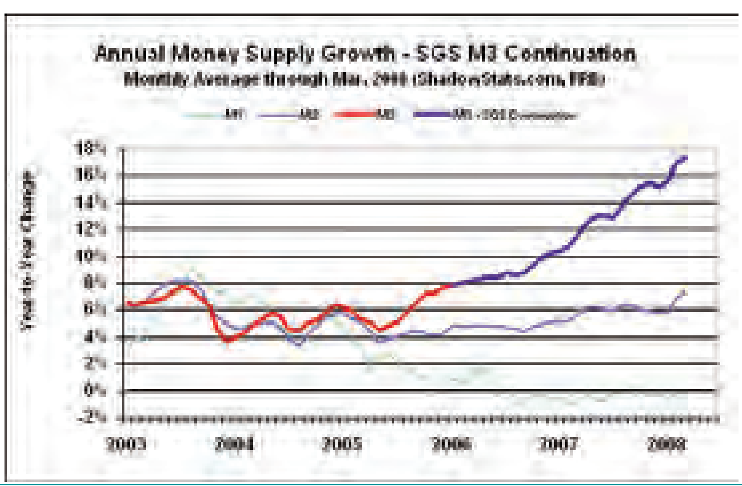
> *Financial Times, January 11, 2008*

Unfortunately, the measures introduced this far by the Fed (massive liquidity injections, rate cuts, and new lending mechanisms) are toxic for the dollar. While the Administration pays lip service to the "strong dollar policy," the Federal Reserve is doing its best to destroy the currency. The most direct measure of the Fed's inflationary monetary policy can be found in the measurement of the money supply, which conveniently, the Fed no longer publishes. As shown in the chart below, M3, the most comprehensive measure of money supply growth (also known as currency debasement) is growing at a staggering 17% annual rate—a bad omen for the dollar.



5. Foreign-Held Debt and the Repatriation of U.S. Dollars

Our chronic budget and current account deficits have led to a tremendous accumulation of dollars abroad. Some estimates show the total at over $7 trillion. China alone holds over $1.3 trillion.

In the past, the US dollar has been considered a “safe” currency because of its wide acceptance and history of stability. With the steady decline of the dollar in recent years, however, many investors abroad are rethinking the wisdom of holding dollar-denominated assets.

For the past two years, China has expressed a desire to diversify away from the US dollar. During that time, however, China has nearly doubled their holdings. If China does begin to dump their dollars in earnest, the dollar will drop significantly. China, aware of this fact, has used this as a political weapon against the United States.

> *“The Chinese government has begun a concerted campaign of economic threats against the United States, hinting that it may liquidate its vast holding of US treasuries if Washington imposes trade sanctions to force a Yuan revaluation.*
> *“Two officials at leading Communist Party bodies have given interviews in recent days warning - for the first time - that Beijing may use its $1.33 trillion (£658bn) of foreign reserves as a political weapon to counter pressure from the US Congress.”*
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> *- Telegraph, October 8, 2007*

The unfortunate reality is that even an organized diversification away from the US dollar will create significant, long-lasting downward pressure. Needless to say, an intentional dollar-dump could be devastating enough to ravage the American economy.