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## The US dollar may remain weak for some time

Seeking to spur the economy to growth, the Fed and the Treasury have been actively devaluing the dollar. Many reasons are given - protecting American exports, saving jobs, preventing deflation, for instance - but there is no question that Capitol Hill is actively engineering the dollar's demise: 18 rate cuts since 2001, three tax cuts, massive deficits, and record money creation all bear witness to its manipulations.

One does not spend ones way to prosperity; no nation ever has or ever will. A look at US current policy shows that this is the basis of U.S. and Fed monetary policy. Never in U.S. history have the imbalances in the economy been so pronounced, or so dangerous.

According to the macro indicators that the International Monetary Fund (IMF) uses to assess emerging-market economies, the United States fell between Turkey and Brazil.

**Many experts are beginning to agree with my earlier recommendation that Investors contemplating the purchase of U.S. dollar-denominated assets would be wise to factor in significant dollar depreciation over the next few years.**

Despite the apparent conspiracy against it, the dollar has avoided a downright free fall so far. That is because dollar investors across the globe are still convinced that, given favorable credit conditions, the U.S. economy will surely recover back to the heyday of the late 1990s, taking dollar – denominated assets to new heights. I believe that investors will soon WAKEN UP. It's true that, the stock market rallied briskly in the recent past, but the U.S. economy continues to struggle. Unemployment persists. And the twin deficits loom larger than life. If and when America's creditors domestic and foreign decide the country's massive, record-breaking level of debt is reason enough to get out of their dollar investments, the dollars value fall sharply.

I cannot predict when exactly that moment of truth will arrive, but I strongly feel it cannot be far off. Excessive debt is not the only ominous development in the U.S. economy. Just as concerning is the American consumers' persistent belief that they are wealthier than they actually are. U.S. financial assets are, once again, in the grip of a large bubble. Take stocks, for instance. Investors are still behaving as if it were the halcyon days of 1999. If the S & P 500 – an index made up of the country's largest companies – were to trade at its historical fair value, or at a price-earnings (P/E) ratio of 15, it would have to decline by 50 percent off its high. But bull markets don't typically start at fair value. For those members who may be in doubt, it would be clear if a new bull market were really starting – and stocks were actually undervalued. The S & P would be trading 67 percent lower, at a P/E of 10. But it's been so long since investors have seen P/E ratios in this range; they now seem to be conditioned to believe stocks will never descend from their lofty heights.

Foreign investors are especially burned when stocks and the dollar go in different directions. At first, perhaps, the rallying U.S. stock market seems like a very inviting place for capital. The risk return ratio suggests differently. All foreign currencies are welcome, but not all are treated equally. For example, the S & P 500 soared 26.4

percent in 2004, in U.S. dollar terms. Yet euro – based investors in U.S. stocks would have realized only a 6 percent gain for the year.

Foreign bondholders are faring no better. Foreign central bank holdings of Treasury and agency securities total over $ 1 trillion. Roughly speaking, every 10 percent drop in the dollar's value impoverishes the foreign creditors by about $ 100 billion on their U.S. Treasury holdings alone! **That is serious money!**

The Federal Reserve Board is working to raise the inflation rate, while the U.S. Treasury is trying to talk down the dollar exchange rate. Not every day does the world's major power pursue a policy of currency devaluation. Even less frequently does it have the courtesy to tell its creditors what it is doing?

**The Fed and Treasury are engaged in a kind of collusion to lower the dollar's value. This in my opinion is a very dangerous game to play, especially for a country like the United States, which relies so heavily upon foreign capital to finance its economy. It has become fashionable in the corridors of power in Washington to advocate "market-based" exchange rates – code for "weak dollar".**

In the olden days, of course, the Fed was supposed to pursue "monetary stability." But in the enlightened twenty-first century, the Fed has much grander designs. It would seem to imagine itself a kind of marionette master to the world's largest economy, making it dance whenever it wishes, simply by tugging on one little interest rate, or by tugging on the dollar.

While the dollar has been tumbling, the US manufacturing sector has been struggling just as much as when the price of a Euro was only 83 cents to the dollar. In fact, the US will be poorer for embracing the policy of competitive devaluations. The problem is, once a devaluation trend begins, it is effectively impossible to stop.

Since my prediction "Gold to shine again", the gold price has indeed jumped 367% from April 2001 to January 2008, from $ 255 to $ 936. The metal's impressive rise inspired a dramatic rally in gold shares that have vaulted the XAU Index of gold stocks to an all-time high of $197.3 as of January 14, 2008.

Does the gold market know that, as the Iraq situation remains, the dollar will continue to suffer? Or maybe the gold market knows only that U.S. financial assets are very expensive, and worries, therefore, that U.S. stocks selling for 35 times earnings and U.S. bonds yielding 4.5 percent are all too pricey for risk-averse investors to own in large quantities. A vicious cycle is hard to stop. **The dollar's descent is the most worrisome and influential trend in the financial markets today.**

When a currency falls, in theory anyway, interest rates usually rise. A government whose currency is falling apart tries to make assets denominated in that currency more attractive by paying higher rates of interest to potential investors. If the government does not raise rates, the market will do it by selling off bonds and driving yields up. Thus, in theory, one would normally expect to see a falling U.S. dollar accompanied by rising U.S. interest rates. The difficulty from the Bush/Greenspan/Bernanke perspective is that rising long-term rates pose an enormous problem: They make it significantly more expensive for debtors – from U.S. consumers to the U.S. government – to service their obligations, and these costs are not negligible.

In fiscal year 2007, for example, the US government was obliged to pay out an enormous $ 429 billion in interest on the public debt outstanding. At a 1 percent rise in interest rates, that would add $ 43 billion in interest costs. To meet this added interest expense, the government would, of course, have to float even more bonds, and at the higher interest rate. This scenario is the US government's nightmare.

When the falling dollar eventually pushes interest rates up, the Treasury will have to issue more debt at higher interest rates simply to pay off its existing debt. But if the Asian economic juggernaut were to discontinue recycling its excess dollars into U.S. government bonds and Fannie Mae debt, the dollar would suffer badly. The question is will the US luck run out?

In some shape or form foreigners lend the US $ 1 trillion every year. However, they do not forget to repay their creditors with ever-cheaper dollars. In the future, the day could dawn when foreigner governments would lose interest in subsidizing the USA's consumption habit. Many Asian central banks are currently exploring ways to reduce their U.S. dollar exposure. The Chinese are no longer seeking US Treasury paper for its great investment attributes because of a technical need to maintain the Yuan/dollar peg.

The dollar is a currency fated to lose value. The dollar's resistance to its debt load, fueled by the machinations of central banks and the misguided faith of dollar investors, undoubtedly qualifies as a trend with a false premise, and this trend will be discredited.

**Members who are worried about the US dollar's decline and looking for an alternative investment should consider investing in RIO's Fixed Income Bond which is Sterling based and offers the added security of a 100% capital guarantee, coupled with an attractive 9% per annum income. This is paid directly to the investor's chosen bank account. Alternatively, members interested in capital growth opportunities should consider the RIO Prestige Performance Fund, which is also Sterling based.**

**RIO Professional Investors Fund although based in dollars has produced a +6.94% gain during April with all trades closed out in profit by month end. May is set to post further profits for the fund as all new trades placed by me at the beginning of this month have been closed out in profit. The active trading I am currently utilising will continue to produce further gains as long as market volatility continues. This fund is a mid risk fund yet is producing gains one would normally associate with a high risk investment which is something I am proud off. The target return for the fund is 15% per annum which has already been surpassed in a brief 5 months of trading.**

**William Gray**
**Executive Chairman**
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