Are Currencies about to Crash?

11th December

Are you ready for the US to debase its currency, to which it is dedicated?

I would point out that there is a risk in holding cash in an environment of asset price inflation - a condition that usually occurs when governments create large fiscal deficits and inflate the money supply. The practice is endemic to banana republics and declining empires. I believe this is happening to the US right now.

The global recession and financial crisis have refocused attention on government stimulus packages. These packages typically emphasize spending, predicated on the view that the expenditure 'multipliers' are greater than one, so that gross domestic product expands by more than government spending itself. Stimulus packages typically also feature tax reductions, designed partly to boost consumer demand (by raising disposable income) and partly to stimulate work effort, production and investment (by lowering rates).

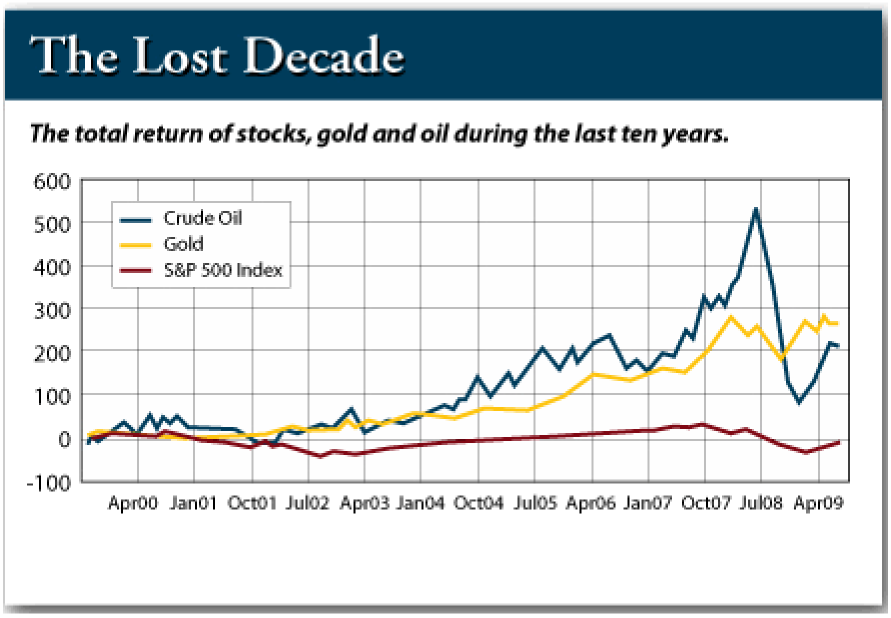
The existing empirical evidence on the response of real gross domestic product to added government spending and tax changes is thin, but the evidence is quite strong that these policy responses usually trigger inflation.

Anyone with common sense would understand that a "strong currency" over long periods of time reflects a high degree of prosperity and economic success, whereas a chronically weak currency is symptomatic of economic imbalances, such as a lack of competitiveness or overconsumption, arising usually from excessive supply of money and credit.

Should the US dollar loses 50% of its value against all other world currencies (everything else being equal), this means that the US becomes 50% poorer relative to the rest of the world, although this is not entirely correct, since the US has overseas assets that would appreciate in value in USD terms.

It is important to note that stock price movements become extremely volatile and erratic in countries with a depreciating currency. In the long run, the depreciation of the currency will usually more than eliminate the gains in local currency terms. Thus, whereas in 2007 both the Dow Jones and the S&P 500 exceeded their previous highs reached in 2000 in US dollar terms, these indices failed to make new highs in Euro terms. In addition, whereas the US economy expanded in US dollar terms between 2001 and 2007, in Euro terms it actually contracted!

Even with the S&P 500 having shot up since the beginning of the year by over 25%, it has merely kept pace with the price of gold. During the past 10 years, the S&P has lagged behind the official US inflation rate, while lagging very far behind both the euro and gold. Sine the end of 1999, the S&P 500 has delivered a total return after inflation of about MINUS 25%.



More importantly, the US is not the only country that is busily debasing its currency. "Everyone" is doing it. Because of the current collective debasement of all paper currencies by central bankers, I believe that precious metals and mining companies will maintain their purchasing power.

In the 1980s the US dollar was a very strong paper currency compared with the Mexican Peso. Today, there is no paper currency that is as strong relative to the US dollar as the US dollar was relative to the Peso in the 1980s! The only "currencies" that have a chance of becoming as strong against the US dollar as the US dollar was against the Peso between 1979 and 1988 are precious metals such as gold, silver, platinum, and palladium.

Furthermore, I should add that precious metals could appreciate even if the US dollar miraculously recovered strongly against foreign currencies for an extended period of time. Such dollar strength would probably be a symptom of some horrible economic or political problems around the world, which could be friendly to precious metals. **This is why members should take a second look at RIO's Professional Investor's Fund which trades Gold. As such it is a likely benefit in today's unsettled times. To date my prediction that gold would shine again, made way back in 2003 in the tenth RIO anniversary booklet, has proved accurate.**

Central bankers and pundits seem to believe that they have averted the second Great Depression, while ignoring the fact that more and more debt produces less and less GDP and fewer and fewer jobs.

For now, however, the low ten-year bond yield is the lifeline from which all support flows. I believe that much of the investment universe holds together because money can still be had cheaply - not by the volition of a cooperative private sector, but rather as induced by a US government that simply distributes money for free.

I would state that private lenders comprehend the difficulty of making profits when being forced to lend for nothing, and so the government increasingly finds itself to be the interest-free lender of last resort.

If central bankers continue this process for long enough, it is the dollar, and any currency or economy still pegged to it, that could eventually crash. Which would benefit Gold **Again, I would point out the RIO Professional Investors Fund has increased it trade weighting for gold and as such can hold up to 85% of the fund's assets in this metal.**

You may recall that I predicted the mortgage market meltdown and financial crisis, which has in fact changed the world. Therefore, investors find themselves in the precarious position of having to maintain sufficient liquidity, but only sufficient, in case the real value of these liquid reserves is wiped out by politicians and central bankers.

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