Certified Gold Exchange, Inc.

ORE-VISION

Views and Analysis on the Economy and Precious Metals

A QUARTERLY NEWSLETTER

3rd QTR 2004

VOLUME 19, NO. 3

The Dollar and Rising Rates

Adam Hamilton, CPA

While the currency markets usually move with all the sound and fury of a glacier, some rare crosscurrents are converging to make for an exceptionally interesting summer in this enormous arena. The world's reserve currency, the mighty US dollar, is ground zero for these titanic colliding forces.

What chill winds are beginning to buffet the greenback? First, the Federal Reserve is preparing to raise interest rates in the States from their nearly *half-century* lows. Second, inflation is on the rise as the massive excess liquidity pumped into the economy by the Fed bids up prices on nearly everything important to living.

It is not too often that rate hikes from the lowest levels in modern American history coincide with a major surge in headline inflation, so the ultimate impact on the dollar ought to be interesting. Wall Street believes higher rates are going to be very bullish for the dollar and attract new foreign investment into the US stock markets, but contrarians like I am not so sure.

Per classic economic theory, the rising rates indeed *ought* to be bullish for the dollar. The higher the returns that a given currency offers, the higher its international demand grows. While this economic principle commands much airplay these days, the more I ponder it the more I conclude that key foundational elements are missing this time around in the peculiar case of the US dollar.

In order for higher rates to boost demand for a currency, several core conditions must be in place. First, the rising rates on the currency must be attractive *relative* to those available in other major currencies. Second, the rising rates must move up *relatively faster* than those of alternative major currencies in order to maintain this competitive advantage. Finally, the actual *real rates* of return in the currency must be positive.

Unfortunately the US dollar fails all three of these core condition requirements underlying the classic economic theory on international currency demand, leading me to believe that it is not wise to expect rising rates to significantly boost the dollar's flagging fortunes any time soon.

In the States today, the overnight rate that the Fed directly sets is only 1.00% now, a half-century low. The futures market is now discounting a Fed Funds rate of 2.25% by year end, or a 125 basis point increase from today's incredibly low levels. The markets expect these rate hikes to begin in the next couple weeks, at the Fed's meeting at the end of this month. And Wall Street expects a big surge in dollar demand.

Continued on page 2

Plunging Interest Rates can have a Golden Lining

Dr. Richard S. Appel

June 20, 2004 - A change in the psychology and actions of a large segment of the American population was severely altered when the Federal Reserve Board aggressively drove down short-term interest rates. For several years short- term rates on 90 day Treasury Bills were quite stable. They offered their holders annual rates of return above 4%, and occasionally exceeded 5%. In fact, 2000 witnessed these short rates rise above 6%. When that occurred, the lives of the investors who owned these and other short-term monetary instruments seemed certain to improve. This was due to their belief that the added income accruing from these investments would increase their purchasing capacity, and would allow them to experience an easy, more worry-free existence. They felt that they could lead a more comfortable life because their incomes had improved. Unfortunately, this mind-set was as short-lived as the fleeting +6% interest rates. For many, this brief period of contentment was soon replaced by the worst of all worlds.

Continued on page 2

Plunging Interest Rates can have a Golden Lining

Dr. Richard S. Appel

Continued from page 1

A large and growing contingent of Americans live on fixed incomes. They are either retired or soon to be, and their primary source of income is largely generated from dividend or interest bearing accounts, or instruments whose rate of return is predicated upon the interest rate level. They may have savings accounts of one form or another, bonds or annuities, or one of a multitude of interest sensitive products. These individuals use the principle or interest generated by their investments to supplement their social security payments. Further, many of the throngs of baby boomers plan to shortly join their ranks, when they too will retire. Many individuals from this latter group are increasing their more stable investment type holdings as they near retirement, and their aversion to risk rises.

We all structure our lifestyles based upon the amount of income that we expect to receive on either a weekly, monthly, or annual basis. This is the sum of earnings from our employment, investments, various businesses, as well as our anticipated interest and dividend payments. When one approaches or reaches retirement, the primary source of their lifelong income, their salaries, is removed from their income equation. It may be replaced by social security or other retirement benefits, but seldom are these as great as the salaries that they will no longer receive. Further, retirees desire a greater sense of

Continued on page 3

The Dollar and Rising Rates

Adam Hamilton, CPA

Continued from page 1

But, compared with rates of return available in other countries today, the initial rate hikes will not be able to make the dollar *relatively* attractive to foreign investors. In the US, a 1-year Treasury Bill only yields 2.14% today in nominal terms. If the Fed hikes by 50bp, a big initial move, then this 1y T-Bill yield will probably migrate up to 2.60% or so. Will this be relatively attractive? Not really.

In the United Kingdom today for example, the local 1-year government bonds equivalent to US 1y T-Bills are currently yielding 4.98%, or 1.9x as much as US T-Bills would *after* the initial 50 basis point move! On the other side of the world in Australia, its own 1-year government bonds are yielding 5.20%, or twice as much as the American yields. Even *after* the initial US rate hikes, the US dollar returns are going to be far *below* those available in other major First World nations. The dollar is not going to look relatively attractive by any means.

And central banks are notorious for acting like a herd of sheep. When one acts, the rest tend to move in sympathy as well. Peer pressure in central banks appears to be worse than in high school. So there is a significant probability that a doubling of overnight rates in the US this year would spur other central banks into action. And any foreign rate hikes would make the relative increase in the States look smaller in comparison, reducing its impact in the global currency markets.

Finally, in addition to being relatively unattractive even after the initial hikes, the *real* inflation-adjusted returns on the dollar will remain abysmal. Foreign investors who buy the dollar are guaranteed to lose purchasing power in dollar terms every year that they own US securities. These negative real rates are glaringly obvious to prudent global investors. Rising nominal rates while real rates remain negative is like lipstick on a pig, a small cosmetic band-aid woefully inadequate to mask a huge underlying fundamental problem.

The US Consumer Price Index inflation report, this week really highlighted the rising menace of inflation. Year-over-year, the CPI is now up by 3.05%. And this official number is almost certainly lowballed as the US government has huge economic and political incentives to report inflation as low as possible. Hedonic deflators and other black statistical arts are actively employed to ensure that this headline inflation number remains tame.

With inflation now running at least 3.05% annually in the US, and 1y Treasuries now yielding only 2.14%, real rates *are* negative 0.91% now. Even after the first 50bp hike by the Fed, real rates will still likely be negative 0.45% or so, guaranteeing foreign investors real purchasing-power losses if they buy dollars. The economic theories on the effects of interest rates on currencies are all based on normal *positive* real returns, not anomalous central-bank-spawned negative real-rate environments.

And as rates in the States rise, inflation is only expected to grow worse. The Financial Times just reported that a whopping 87% of fund managers surveyed expect higher inflation in the US in the next year. Odds are this higher inflation will effectively offset rising nominal rates, keeping real rates of return in the US negative for some time to come and short-circuiting economic currency models based on positive real rates.

All of this theory is certainly not difficult to understand, but the surging US stock markets and recent dollar strength seem to back the bullish thesis asserting that much higher dollar levels are

Continued on page 3

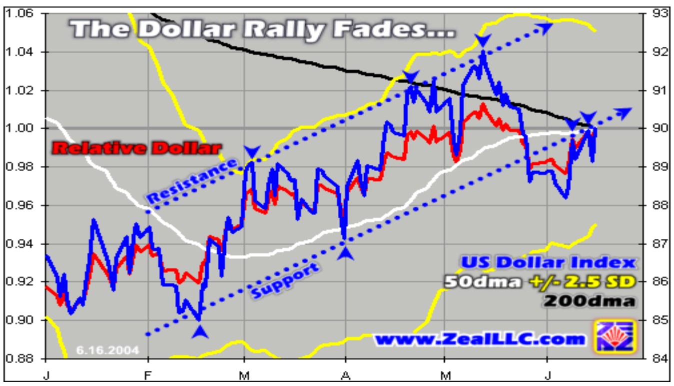
The Dollar and Rising Rates

Adam Hamilton, CPA

Continued from page 2

approaching. If you are immersed in the day-to-day news-flow of the American markets these days, I think you would have to admit that the general sentiment ahead of the coming rate hikes has been remarkably positive.

Provocatively, however, the technical evidence on the dollar charts is not bullish at all but actually is rather bearish right in line with the contrarian theory on relative international returns and negative real rates. Our next two charts highlight this fascinating divergence between the prevailing dollar sentiment and the actual current technical dollar scene. At the moment, at least technically, the contrarian case for dollar weakness is dominating the price charts, both short term and long term.



The first half of this year witnessed a very impressive dollar rally, which was expected in early January as the dollar bounced off key technical lows. From its ultimate trough near 85 in mid-February to its peak near 92 in early May, the US Dollar Index managed to carve a very impressive 8.2% rally over 61 trading days. This is really a major move in the world's reserve currency, which tends to move as slow as molasses.

Like most major rallies, the dollar proved no exception in establishing a well-defined uptrend pipe as 2004 marched on. This is drawn in blue above. The dollar behaved rather nicely from a technical perspective, grinding its way higher while bouncing within its uptrend channel several times from its lower support and upper resistance lines. The dollar bulls indeed had good reason to be excited in recent months, until late May.

Towards the end of May, the dollar started selling off as it had a couple of times before during its 2004 rally. This time, however, the selling didn't stop at the dollar's lower support line. As you can see above, the venerable US Dollar Index plunged below its short-term uptrend support, a technical breakdown. And even after three valiant attempts to break back above in June, this former support line is now acting as oppressive overhead resistance.

When price trends are changing, it is not uncommon for former support to become new resistance. As more and more traders perceive that an old support line is now becoming resistance, they grow discouraged and selling increases. Since so many countless market players watch the charts, to a very real degree the charts directly influence speculator psychology which drives actual buy and sell decisions. After three successive attempts to break decisively above the old support line were repelled and failed, the dollar's short-term fortunes are looking increasingly cloudy.

Continued on page 4

Plunging Interest Rates can have a Golden Lining

Dr. Richard S. Appel

Continued from page 2

security because their income is limited and they must rely on their finite, life-time accumulated wealth. To this end they husband their assets in the best fashion that they can. This motivates many to shun equities and other forms of investments due to their great volatility, and the potential for losing their assets from falling market prices.

Due to the enormous population of baby boomers, our nation consists of an increasing number of families that are dependent upon the returns from their interest sensitive investments. If their income is stable, they will have one less thing about which to be concerned. To these people, fluctuating interest rates pose great risk. They have already planned their spending decisions around their new income, and can suffer great hardship if their income stream is impaired. This will occur when interest rates sharply fall.

Interest rates rose strongly in late1999, and peaked in 2000. When that occurred, 90 day Treasury Bills offered their owners an annual rates of return in the 6.50% range. This was significantly higher than the 4.50% to 5.50% rates that these instruments yielded for the prior several years. While it lasted, the more robust yields offered those who heavily relied upon their interest and dividend returns a ray of hope. They thought that this was

Continued on page 4

Plunging Interest Rates can have a Golden Lining

Dr. Richard S. Appel

Continued from page 3

the beginning of better times for them because they anticipated increased weekly or monthly interest payments. Unfortunately, from that fleeting high point interest rates in general, and short-term ones in particular, began to plummet.

In September 1999, a Dow Theory Bear Market was signaled. Later, in January 2000, the U.S. stock market as measured by the Dow Industrials peaked, and shortly thereafter the economy began to show signs of weakness. By the end of 2000, anecdotal evidence of an economic decline was already building. This was largely due to the earlier fiscal and monetary policies that the government and Fed had executed. These first fostered and then perpetuated, the unsustainably high standard of living that this nation enjoyed for decades. Recognizing the potential for a severe economic collapse created by this condition, Alan Greenspan understandably became quite concerned.

In the winter of 2000, Alan Greenspan's response to the falling stock market and weakening economy, was to abruptly force down interest rates. After all, whenever faced with a contracting economy, that was the same method that all earlier Federal Reserve chairmen used for the prior six decades. Greenspan knew that this action worked! By reducing interest rates, the Fed chairman similarly hoped to

Continued on page 5

The Dollar and Rising Rates

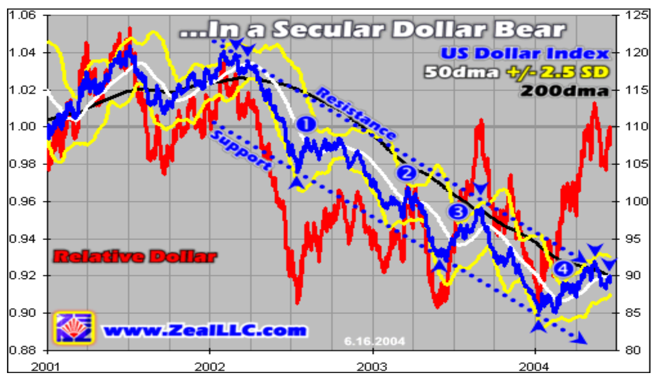
Adam Hamilton, CPA

Continued from page 3

Adding even more intrigue, today's stubborn resistance now coincides exactly with the 200-day and 50-day moving averages of the US Dollar Index. These important lines are as widely followed as the linear trend lines and the inability of the dollar to break above these soon will further poison sentiment among short-term currency traders. If speculators don't believe a price can head higher, then it can become a self-fulfilling prophecy as they cease buying and start selling.

At any rate, the short-term dollar chart that was so bullish between January and May has now turned bearish. Former rock-solid support is now acting as resistance and the short-term trend seems to be changing for the worse. This uninspiring technical picture supports the bearish contrarian thesis that rising rates, at least initially, are not going to be anywhere near as bullish for the dollar as Wall Street stock perma-bulls are desperately hoping.

And if the short-term dollar scene is rapidly fading to the dark side as the dollar's 2004 rally fades, the long-term picture is even worse. On a long-term chart the major dollar rally we just witnessed earlier this year looks like nothing more than a garden-variety bear-market rally within the dollar's powerful secular bear market.



Since topping in 2001 after a very powerful six-year secular bull, the dollar has been firmly entrenched in its current secular bear. Just like winter inevitably follows summer, bear markets inevitably follow bull markets. This endless cycle has always existed in the financial markets and I suspect it always will. The biggest problem for bulls right now is the current duration of this secular dollar bear.

Using the most conservative lifespan possible for this long-term bear, it topped in mid-2001 in absolute terms so it is only three years old now in mid-2004. In reality though, it carved a second slightly lower double top in early 2002 so it would not be at all out of line to consider it a half year younger than three years today. In modern history, the average secular bull or bear market in the US dollar has run five to seven years in duration. So at only circa three years old today, odds are this dollar bear is only halfway over or so!

Further complicating life for the bulls, the average decline in the previous secular dollar bears ending in 1980 and 1995 was around 40%. If this historical precedent holds true today, then we are looking at a potential secular bottom in this dollar bear around 72 on the US Dollar Index. If you are keeping score that is another 20% lower *from here*. Thus in historical context this dollar bear is not only half over in terms of duration, but only half over in terms of depth. No, the current long-term dollar outlook is certainly not pretty by any stretch of the imagination!

Continued on page 5

Plunging Interest Rates can have a Golden Lining

Dr. Richard S. Appel

Continued from page 4

stimulate business and investment, to reverse the economic decline and soften the stock market's fall. Unfortunately, the declining interest rate environment wreaked havoc upon those who were accustomed to the higher and relatively stable interest rate levels of the past. These people became trapped, and were forced to live on a significantly smaller income.

Finally, when interest rates bottomed in the summer 2003, 90-day Treasury Bill rates were yielding below 1%. This placed thousands upon thousands of households in the precarious position of not knowing how they would continue the living standards to which they had become accustomed. Those who could earlier, comfortably survive solely on their dividend and interest payments now had to use some of their principle. Others who were already also living off of their assets were forced to draw them down at a faster rate. In both instances, fear ran through those who were now forced to face the possibility that they might outlive their assets. Panic set in among many of these individuals.

Faced with the real fear of having to either sharply curtail their spending or to run out of assets and become destitute, many of these people entered the stock market in the hope of achieving a better return on their assets. These people joined others who faced a similar fate, but who began acting in this fashion when interest rates first entered their steep decline. The last individuals who succumbed and moved their assets into equities, would have earlier shunned the idea of taking greater risk to maintain their living standards. They now felt desperate, and compelled to at least entertain the prospect.

Most individuals who invest in interest bearing instruments are conservative by nature. Prior to the last decade it was common to hear statements like, "the stock market is a gamble". This was because in truth it is. Only recently have such statements as, "stocks are a form of savings" filled the airwaves. These conservative investors had taken to heart and understood the true nature of the stock market, and would normally have never considered investing in equities. Yet, the combination of their fear and the endless banter describing common stocks as a method of savings, combined with the widely fostered belief that stocks are assured to go higher in price over time, drove many of these poor souls into the stock market.

This is one of the reasons why stock prices have been so well supported during the past few years. Billions of dollars have been drawn into them by those whose desperation caused them to sell their conservative investments, and reinvest the proceeds into common stocks.

Today, these frightened and hard-pressed individuals have their hopes and future pinned upon what I believe are a series of false beliefs. First, buying stocks are not a form of savings. Ask those who were late to the party and bought common stocks after the Bear Market began. Also, history shows that. "stocks go higher over time" is only a half truth. This only occurs when the frame of reference is over a period of **decades**. For example, those who bought common stocks at the 1030 Dow Industrial Bull Market peak in 1966 were forced to wait over 15 years to break even. The Dow Industrials did post a slightly higher interim top at about 1050 in 1973, but from there it collapsed to 577 less than two short years later. It was not until 1982, when it finally surpassed 1050. Or even worse, those who acquired common stocks prior to the great stock market crash of 1929 would not have recouped their losses until the late 1950's, when the Dow Industrials and S & P 500 again first surpassed their former peaks. How many of today's interest rate dependent investors can wait that long?

Continued on page 8

The Dollar and Rising Rates

Adam Hamilton, CPA

Continued from page 4

This secular dollar bear has also carved an excellent downtrend pipe in the past few years. The major support and resistance lines are drawn in above, with the lower support line better defined with three interim-low bounces so far. I am fascinated by the parallel top resistance line at the moment though, which has so far held as overhead resistance even in spite of our strong bear-market rally in 2004.

Of the four major bear-market rallies of this dollar bear to date, labeled above, our current fourth specimen has been the largest. While it looked so impressive on the first short-term graph, this long-term view really puts it in proper strategic perspective. The dollar had plunged to its lower support line by the end of 2003 so a major rally was due.

This rally erupted right on schedule and carried the dollar all the way back up through its downtrend channel to its upper resistance line. Although challenged in May, this key technical level has not decisively fallen and remains in force. Today the intercept between this major overhead resistance line and the US Dollar Index is running around 90 or so, which not so coincidentally was about as high as the dollar could march before these graphs were created on Wednesday evening.

Thus, from a long-term technical perspective as well, the near-term fortunes of the dollar look quite bearish. All the 2004 bear-market rally did was carry the dollar from

Continued on page 6

Inflation: The Silent Tax

Richard Benson

With the Federal Reserve getting broad money growth, M3, back to around 11 percent a year, and the CPI heading to 3 or 4 percent, investors really need to start thinking about inflation.

Some of you may recall how sky-rocketing inflation affected your life 20 to 30 years ago. The younger generation, having no memory of inflation, can only use logic and imagination to rationalize what's virtually certain to happen. *(Voting records, investor polls, and general observations indicate that the attention span for 90% of the population is only 15 minutes; so anything prior to yesterday is basically ancient history to be soon forgotten.)*

Inflation is a tax on financial assets. This tax is paid by those unlucky investors, corporations and foreign central banks that hold financial assets denominated in the currency that is inflating. A simple way of thinking about inflation as a tax is to consider investing in a mutual fund. The fund manager might charge 1 percent for the service and privilege of providing the investments in fund form. If the fund returns 5 percent, the investor would obviously receive a net 4 percent. However, if the inflation rate was 4 percent, the *real* return to the investor would actually be nothing. In this case, the Fund manager gets his 1%, the U.S. Treasury - with the help of the Federal Reserve - takes 4% because of inflation, and the investor is left with nothing, except, of course, a tax bill for his 4%. After taxes, the investor actually lost money! *Inflation is a silent, and extremely efficient, robber of value.*

Continued on page 7

The Dollar and Rising Rates

Adam Hamilton, CPA

Continued from page 5

the bottom to the top of its secular downtrend channel. So far it just looks like another garden-variety bear-market rally, no big deal. And the dollar already appears to be rolling over and topping since it has not yet been able to re-challenge its 92 USD Index highs achieved in early May.

This behavior fits the natural rhythm of a secular bear amazingly well. During bear markets, prices tend to fall for a while until they grow short-term oversold, then a bounce is due. These resulting bear-market rallies are necessary to bleed off speculative excesses on the short side to prepare the way for the next down-leg. The bear market rallies typically give up their ghosts somewhere near the price's 200dma, just like today.

On the graph above, the red line illustrates this bear-market rhythm beautifully. It is the Relative Dollar, or the US Dollar Index divided by its 200dma. The dollar's down-legs have tended to grind lower until the dollar hits around 90% to 91% of its 200dma, then a major bear-market rally erupts. These rallies carry the dollar up to at least 96% of its 200dma, but sometimes even higher near 101% of it. Yet, just as quickly as they erupted off of Dollar lows, these bear-market rallies soon collapse as the 200dma holds as major overhead resistance.

So, while Wall Street dances around and somehow believes that the US dollar is about to surge into a new multi-year secular bull on rate hikes, the charts just aren't buying this argument. Short-term support just failed and long-term resistance is holding. Technically at least, the bearish arguments on the near-term fortunes of the dollar are far more convincing than the bullish ones.

Finally, another major reason that I suspect that rising rates will actually hurt the dollar, at least initially, is because foreigners are *already* heavily invested in US Treasuries and other American debt. Rising rates are great news for *new* investors, but for investors with *existing* debt portfolios they are like the Black Death. There is nothing that can obliterate the wealth of bond investors faster than rising interest rates.

The latest stats I have seen indicate that slightly more than half of *all* US Treasury debt is held by foreign investors, so this is a nontrivial issue. To illustrate the huge risks to these foreign investors the moment the Fed pulls the trigger, imagine an investor from Europe holding 3-year US T-Notes today. These are neither ultra-short-term nor ultra-long-term in maturity, but pretty average. Today the US 3-years yield about 3.27%, but we will use 3% in this example to make the math easier.

At 3%, every $1000 face value in bonds our European investor purchased yields the equivalent of $30 per year in coupon payments. As long as three-year rates remain near 3%, the European investor does not lose precious principal and earns the 3% per year that he expected. But as soon as rates rise, all hell breaks loose with any bond maturing in more than a year or so.

At the moment US consensus calls for overnight rates to move at least 125bp higher this year, so let's assume the market rate on our European's 3y Treasuries soars to 4% in the months ahead. Our European is in serious trouble now, as he owns US Treasuries yielding 3% but the prevailing market rate is now 4%. No one will be willing to buy his 3% bonds when they can buy brand new 4% bonds instead, so the face value of his *existing* investment will plummet. It will fall until its price is so low that it yields the new market rate of 4%.

Since these bonds the US Treasury sold him at 3% will never pay more than $30 of interest, they

Continued on page 7

The Dollar and Rising Rates

Adam Hamilton, CPA

Continued from page 6

will be sold aggressively in the marketplace. While they traded at $1000 a month ago, a few months from now they will fall until they yield 4% like brand new bonds. In order for a contractual $30 payment to yield 4%, the value of our European's bonds will have to plummet from $1000 to $750 in the marketplace, a horrific 25% loss in supposedly safe US Treasury investing. $30 in interest payments on a bond with a $750 market value now equals the market's new 4% yield. Although this example is simplified, it will still be one heck of a kick in the teeth!

For the legions of foreign investors already heavily invested in the US Treasury market, they will face similar and even larger losses on any US bonds they are holding that mature in over a year. Would you risk losing a quarter or more of your portfolio's value to gain a measly one additional percent in return? Me either! I suspect that foreign investors are going to sell *ahead* of the worst of the rate hikes, dumping their US Treasuries and then selling the dollar proceeds in order to buy back their local currencies.

If they repatriate their capital deployed in US bonds maturing in a year or more now, they can stay safely in their local-currency cash and watch in leisure as the rising rates decimate the US bond markets. Then they can buy dollars later, after the rate hikes, when bond prices are as cheap as they have been in a generation. But initially, up front, they will probably choose to sell their US debt and then US dollars to get out of harm's way before rising rates eviscerate the US bond market.

There are a couple of caveats on this thesis. First, if an investor is willing to hold all of his bonds *to maturity* then rising rates are not a risk. Bond principal is only lost by those actually selling before maturity. Realistically though, most people would want to sell before maturity since it makes little sense to hold an old lower-yielding bond when new higher-yielding ones become available.

Second, this only applies to individual and institutional investors with common sense who actually care about capital preservation. Thus, the massive foreign government holders of US Treasury debt may not care one bit at all and be content to watch their taxpayers' money burn in the coming Treasury massacre. All governments are rightfully notorious for doing stupid things.

While Wall Street trumpets that rising rates are going to boost the US dollar and the US stock markets, contrarians remain very skeptical.

Even after the initial rate hikes, the dollar's returns will remain relatively unattractive compared to other First World industrial powerhouses. Even after the initial rate hikes, the dollar's real rate of return after inflation will still be negative, guaranteeing foreign investors that they will lose purchasing power by buying dollars.

In addition to these factors negating the classical economic argument for a stronger dollar, both the short-term and long-term dollar technicals remain quite bearish. On top of all this, the enormous existing dollar bond portfolios held by foreign investors around the world are going to be crushed when market rates start climbing higher in earnest.

In light of all these serious concerns and bearish factors, odds are the rising rates are not going to boost the mighty US Dollar initially. Indeed, just the opposite scenario seems to be shaping up, with the next major dollar down-leg already brewing.

Adam Hamilton, CPA, www.zealllc.com

Continued on page 8

Inflation: The Silent Tax

Continued from page 6

If you own stocks, bonds, mutual funds, REIT's, or even cash, you'll pay an inflation tax. This tax is the result of the United States' Treasury spending far more than they collect in traditional taxes and issuing debt, which is then bought by the Federal Reserve. The Fed then prints up brand new fresh dollars, out of thin air, to finance the government spending that is not paid for by direct taxes. Since someone owns the existing financial assets, someone will have to pay the tax. The only way to avoid the inflation tax is to hold as much of one's wealth in non-financial assets, but this may be easier said than done.

Small countries, such as Argentina (that run massive budget deficits and need to borrow abroad), borrow in dollars, the world's reserve currency. They have not yet figured out how to trick foreign investors into holding as many assets in their local currency as they would like. Any country that can convince foreign investors to accept assets denominated in their country's inflating currency, effectively steals from them when the country uses the inflation tax and ultimately stage's a massive devaluation of their currency. The inflation tax, for these inflating countries, is usually directed internally to domestic investors, as very few foreign investors can be "conned" into holding the assets of an inflating foreign currency, unless the interest rates offered are extraordinarily high.

U.S. citizens have been very lucky because the dollar remains the world's reserve currency. The fact that everyone will hold dollar investments - under the assumption that the dollar will remain good - has allowed American taxpayers to avoid paying taxes because the U.S.

Continued on page 8

Plunging Interest Rates can have a Golden Lining

Dr. Richard S. Appel

Continued from page 5

Gold has forever been the savior of the common man. Periods of excessive monetary creation, such as the path that the United States is currently following, have ravaged him by inflation unless he owned gold. In times when a country's monetary unit's existence came into question, such as when one nation conquered another, gold has saved the individual's wealth. So too is it today for those who believe that the only hope for their future exists by owning common stocks. They are misguided and should place some of their assets into gold. If I am correct, not only will the stock market trade far lower over time, but gold will soar to heights never before witnessed. This will preserve both the wealth and the future of those Americans who move their assets into the eternal metal, gold.

Dr. Richard S. Appel
www.financialinsights.org

Debt and Trade Deficit Counter
National Debt:
7,216,563,261,307.83
The estimated population of the United States is **294,443,552**
so each citizen's share of this debt is **$24,509.16.**
The National Debt has continued to increase an average of
$1.58 billion per day.

US Trade Deficit:
144.900,000,000.00

Inflation: The Silent Tax

Continued from page 7

Treasury can borrow abroad. This has allowed American consumers to keep spending because foreigners will extend credit to them!

While the Fed has been playing off the deflation fear, our country has collected at least $3 trillion from foreign investors, endowments, pensions, and foreign central banks. This staggering amount of money that we have gotten the rest of the world to give us, could never have been collected had the dollar not been the world's reserve currency. Moreover, we need to finance the continuing massive U.S. consumer-spending spree that encourages our government to foster a policy of sending American factories to Asia in return for their central banks' financing of our trade deficits. *(The Asian central banks will take a massive hit on dollar devaluation.)*

Unbeknownst to most investors, inflation also taxes financial instruments. Consider the poor soul who wants to save enough to buy bonds that will generate enough income for a comfortable retirement. When inflation really kicks in, this imaginary interest on bonds is simply compensation for the falling value of the dollar. On closer examination, to preserve one's capital in an inflationary environment, most of the interest earned must be reinvested or it will be inflated away. But don't forget that the IRS taxes the interest that is paid for the use of the money, as well as the interest that is paid to compensate for the principal that is being eaten up by inflation.

Another example of principal being taxed is when you own an asset, for cash, that keeps increasing in value with inflation. After a number of years when that asset is sold, technically its real value has stayed the same. However, for tax purposes, the tax basis is on the original number of dollars paid. As an example, take a house. Years ago, the house cost $100,000. Inflation comes along and the general price lever doubles, the dollar falls in half, and now it takes $200,000 to buy the same house. When the house is sold, there is a "phony gain" of $100,000 upon which a tax is owed.

Because the cost basis of assets in the U.S. Tax Code is not indexed upwards for inflation, an investor will have inflationary gains that are totally illusionary. While an investor will receive more dollars when he sells his investment, each dollar buys less! The investor is taxed on these illusionary gains as if they were real gains. *In reality, inflation gives the government the power to tax wealth by taxing these phony gains!*

Under inflation, our government is the biggest winner. Not only is the Treasury's debt burden reduced, but inflation automatically raises taxes!

Inflation will allow major fortunes to be made and, unfortunately, lost. With inflation on the horizon, incredible discipline will be required whenever possible to avoid the temptation of owning financial assets unless, of course, you wish to have your investment principal taxed until there is very little left. Richard Benson – www.sfgroup.org

ORE-VISION
Views and Analysis on the economy and Precious Metals

Published by Certified Gold Exchange, Inc.
PRECIOUS METALS ASSET MANAGEMENT