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THE REAL INCONVENIENT TRUTH: It's the dollar that's melting, and your retirement funds along with it!

Traditional investment strategies judge their returns relative to the performance of "the market" (the S&P 500). If the market looses 50%, and they only lose you 45%, they actually think they performed well! Furthermore, they do not adjust for inflation, or for the declining value of the dollar. Did you know that since 2001 the US Dollar has lost about 40% of its value? This means that dollar for dollar, your dollar based assets have likewise lost 40% of their value, in real terms. That is called wealth destruction, but it is stealth, because most people do not realize what is going on.

Absolute returns investors want to make money, regardless of the performance of "the market." The smart ones also adjust for inflation and for the declining value of the dollar. In addition, they pay careful attention to what is going on around the world, the "macro-economic" big picture. In case you haven't heard, here's what's really going on…

Fact: The Federal Budget Deficit for the month of November 2009 was $120.3 Billion dollars (The Deficit is the amount of money the Federal Government had to borrow to pay their bills, aka "living beyond your means").

Perspective: The entire combined net worth of the two wealthiest men in the world, Bill Gates and Warren Buffett, is only $77 Billion.

Fact: The 2009 US Deficit was **$1.4 Trillion.** The Federal Budget was 400% of total Federal Revenues.

Perspective: If you earned $10 per second, it would take you 3,169 years to earn $1 Trillion dollars. In July 2009 alone, the budget deficit was $4 million dollars per minute. You could climb a stack of $1.4 Trillion one dollar bills almost half-way to the moon.

Fact: The US National Debt is **$12.35 Trillion (usdebtclock.org).**

Perspective: This means if you're a tax payer, the government has already spent $113,054 of your money, but just hasn't collected it from you yet. The US Debt to GDP ratio is already 50% higher than the peaks of the Great Depression. A stack of $12.3 Trillion one dollar bills would reach all the way to the moon, 3 times.

Fact: On Sunday, December 13, 2009, the Senate passed a historic $1.1 Trillion dollar spending bill for the government, including in it a proposition to raise the debt ceiling above $12.1 trillion so that the US Treasury can continue to borrow increasing amounts of money.

Fact: On Thursday, January 21, 2010, the Senate opened debate on a plan to raise the debt ceiling by an additional $1.9 Trillion to accommodate additional government spending, moving it to a record $14.29 Trillion!

Speculation: According to the January 31, 2010 Wall Street Journal, "the President is proposing a $3.8 Trillion dollar budget for 2011 that projects the deficit will shoot up to a record $1.6 Trillion this year." This is 10.6% of our GDP, the highest record deficit since WWII!! Plans to reduce that number on the future are all based on the uncertain assumption of future economic growth.

Perspective: The fundamental reason why the dollar hit a weak trend in 2001 was because the U.S. Federal deficit reached 4.5% of GDP. The President's most optimistic projections are that the deficit will average 4.5% over the next decade, and then increase again due to the retirement of baby boomers, which is expected to result in increased spending in Medicare and Social Security. Could this be the writing on the wall?

Speculation: "Unfunded obligations" for entitlement programs like Social Security and Medicare, are estimated to total **$106 Trillion** dollars, or $344,000 per citizen. This is 780% more than the National Debt.

Perspective: Our nation's total assets equal only $74 Trillion, or $240,000 per citizen. When unfunded obligations are taken into account, our nation is broke and is living off of borrowed money. The only question is if foreign creditors will continue to lend to us indefinitely? When an individual borrows 100% of their credit limit, creditors stop lending to them. Might foreign creditors eventually do the same?

Fact: In 2009, over **128 US banks** failed, the highest number of failures since the Savings & Loan crisis in 1992. The FDIC Deposit Insurance Fund has slipped into the red for the first time since 1991. In Sept 30, 2009, the value of the fund was $8.2 Billion in the hole.

Perspective: In 2007, 3 US banks failed.

Fact: There are **552 more US banks** still on the FDIC "watch list" for having failed the grading system. The record high was 575 banks in 1993.

Perspective: The FDIC already ran out of money once, assessed its members $5.6 billion more in funds, and is currently scrambling for ways to get more money for its insurance fund, so that it can liquidate more banks.

Fact: The Dollar has **lost about 40% of its value** since 2001.

Perspective: What this means to you is that, dollar for dollar, your dollar based assets have likewise lost 40% of their value, in real terms. That is called wealth destruction, but it is stealth, because most people do not realize what is going on. On Nov 30, 1999 the S&P Closed at 1,139. 10 years later, on Nov 30, 2009, the S&P closed at 1,095. Holding the S&P for the last 10 years would have resulted in a small loss of value in nominal terms, but a huge loss of value in real terms, when adjusted for the value of 2009 dollars versus 19999 dollars.

Fact: The US 10-Year Treasury note, priced in Gold, already shows a **decline in value of 50% below its 1995 value**, in real terms. US Treasuries are supposed to be a “safe” investment.

Fact: Since August 25th, gold has gained over 12%.

Perspective: What was announced August 25th that has to do with this gain in Gold? On August 25th, the President announced that Ben Bernake would be reappointed Fed Chairman. Coincidence? Is this the international community’s way of tell us how they feel about Bernake’s monetary policy?

Fact: Official Unemployment in the U.S. is 10.2%, as of October 2009. The Underemployment Rate, which includes people with part-time jobs who would like to work full time, is 17.5%, the highest it’s been since the Great Depression. The number of the Actual Unemployed (known as U-6) is over 26.5 million people, all scrambling to make ends meet and not end up living under a bridge along with the rest of their family, whom they are struggling to support.

Speculation: On January 20, 2010, the Brookings Institution came out with a warning stating that 30% of the nation was either in poverty already or headed to it. The report stated, “The US is becoming like a 'developing nation,' with 39.1 million people living in poverty. Many cities have already reached the 30% poverty rate - including Cleveland, Detroit, Youngstown, Buffalo, Syracuse, Dayton and Hartford, Connecticut. But poverty is increasing fastest in the suburbs”

As a side note, about 40 million Americans are also living on food stamps. This is a new record.

Fact: Chris Manning of the Bureau of Labor Statistics (BLS) admits that the unemployment situation is worse than what the BLS reports. He stated that payrolls were overestimated by 824,000 in the twelve months ending March 2009. The source of this error was the birth/death model. BLS uses "plug" numbers for the number of births and deaths. These "plug" numbers were wrong. They led to estimated positive contributions to employment that were way too high. The birth/death model was adding significantly to payrolls when all other payrolls were actually falling. In reality, the contribution from net births and deaths was in fact negative. Is this admission of error just the tip of the iceberg?

Speculation: Houses are like handcuffs to job seekers. In the past, when you landed a job in another city, you simply sold your house and moved. Now, with homes having lost so much value, the “pick up and move” scenario is increasingly difficult.

Fact: 14% of the US homeowners are either delinquent on their mortgage or in some stage of foreclosure, and most of these are prime loans, not sub-prime.

Perspective: This is the highest rate since they started tracking this data in 1972. The main economic driver of the economic growth from 2002 – 2007 was home owners using their homes as cash machines by pulling equity out of their homes. This source of economic growth has disappeared.

Fact: According to RealtyTrac, the bean counters in the housing sector, nearly 3 million households received at least one foreclosure notice in 2009. That represent 1 out of every 45 homes, which is a 21% increase over 2008.

Speculation: Some banks report seeing so many foreclosures that many are delayed simply because there are delays in processing the delinquent loans! There are millions of loans whose interest rates are due to reset later this year. If the Fed moves interest rates higher, these loans will be at a huge risk of default.

Fact: A Commercial Real Estate meltdown is occurring, with the first casualty being Corus Bank of Chicago, the 2nd largest bank to fail in 2009.

Speculation: Gulf Arabs have stated that they are planning – along with China, Russia, Japan and France – to end dollar dealings for oil, moving instead to a basket of currencies including the Japanese yen and Chinese yuan, the euro, gold and a new, unified currency planned for nations in the Gulf Co-operation Council, including Saudi Arabia, Abu Dhabi, Kuwait and Qatar.

Fact: Countries are beginning to remove the dollar as the de facto "settlement currency" for international transactions. China has signed currency swap agreements with countries in Southeast Asia, and Argentina, and Brazil. As they spread those currency swap agreements around the world, they remove the dollar from the settlement, and replace it with renminbi. These currency swap agreements could total 1/2 of China's total exports, which is equal to about $2 Trillion in annual trade flows.

Fact: The 4 biggest pools of dollars are held by China, Japan, Russia, and India, as part of their central bank's foreign reserves. China's central bank owns $800 billion in US Treasury notes. Russia has $430 Billion US Treasuries in its foreign currency reserves. Both China and Russia have been actively calling for the creation of a new world reserve currency. All of China, Russia, India and Japan are diversifying away from US$ in their foreign currency reserves.

Perspective: Joseph Stiglitz is a Nobel Prize winning economist and Columbia University Professor. "The dollar's role as a good store of value is questionable and the currency has a high degree of risk," Stiglitz said at a conference on August 21, 2009, "There is a need for a global reserve system. The currency reserve system is in the process of fraying. The dollar is not a good store of value." All dollar denominated assets loose value when the dollar looses value.

Fact: China has quietly shifted its reserves out of long-dated treasuries with 10 and 30 year maturities, and moved them to treasuries with an average 3 year maturity.

Fact: Central banks currently hold 62% of their currency reserves in US$. Only 37% of new reserves are being places into US$, and 67% into Euros and Yen. This puts downward pressure on the dollar and upward pressure on the Euro and Yen.

Fact: Two years ago the Fed Funds rate was 5.25%. Today it is nearly zero. The fiscal deficit was 2% of GDP two years ago. Today it is 13%. Mortgage rates were 6.5%. Today they are 4.7%. The Fed's balance sheet then was $850 Billion. Today it is bloated at $2 Trillion. However, the dollar is almost exactly the save level now, on any trade-weighted measure, as it was back then, due to the flight to the safety of the US Treasuries. These fundamentals point toward a falling dollar, and the "flight to safety" that artificially propped it up is slowly melting.

Fact: Over the past 2 years, the US dollar has been propped up by a "flight to safety" due to the perception of global recession. However, many international markets have already come out of recession, while the US has not. Europe has posted growth. Australia and Norway have already begun to raise interest rates again, to stave off inflation.

Speculation: Now that the international economies are recovering, the above mentioned fundamental changes that have occurred over the past 2 years will begin to be priced into the value of the dollar. Remember, when the dollar looses value, dollar denominated assets loose value.

Speculation: The Fed is already having difficulty selling their new IOUs to foreign investors in order to finance the ongoing deficit. In early August, the Fed auctioned $28 Billion in 7-year Treasuries. $10 Billion was quietly bought back by the Fed, otherwise this would have been a failed auction.

Fact: In 1970, the price of gold was $35 an ounce, and in 1980 gold was $800 an ounce, due to inflation resulting from the vast expansions of money supply.

Fact: The dollar has lost 95% of its purchasing power since the Fed was created in 1913.

Speculation: The Fed has stated that it intends to continue to increase money supply by monetizing the debt at an aggressive pace: as much as $1.25 trillion of mortgage-backed securities, $200 billion of federal agency debt, and $300 billion of Treasuries. They are making these purchases in an attempt to keep interest rates at below market levels to fabricate a refinancing boom. While they have been somewhat successful in keeping rates lower than they would be under normal market conditions, these purchases are extremely inflationary and won't be easily reversed. This also creates the illusion of growth.

Speculation: Was the Fed responsible for the stock market rise in 2009? "The source of approximately $600 billion net new cash necessary to lift the market's overall capitalization by $6 trillion last year could not be identified by TrimTabs," Charles Biderman founder and chief executive of Trim Tabs, said. "The money," he said, "didn't come from traditional players such as companies, retail investors, foreign investors, hedge funds or pension funds. We know that the U.S. government has spent hundreds of billions of dollars to support the auto industry, the housing market, and the banks and brokers. Why not support the stock market as well?" (Click here for the video clip where he goes into more detail during an interview.)

Fact: Based on trailing PE earnings, the P/E multiples on the S&P 500 are a record **500% higher** than what we saw during the peak of the dot com bubble a decade ago. The recent gains in the stock market is not a reflection of improvement in companies, but rather more money chasing these assets. Instead of having improving fundamentals cause sustainable growth, the temporary current rise in the stock market is due to the increase in money supply finding its way into risk assets. This is not sustainable.

Speculation: Richard Clarida, a strategic adviser at Pimco, the global bond giant, wrote a note to clients on Oct. 22, 2009 pointing to "an orderly dollar decline" in the value of the dollar as the "most likely scenario". He added "a disorderly decline, while unlikely, cannot be ruled out."

Speculation: The German government's 5-person council of economic advisers issued a report that said, "After the massive global increase in U.S. dollar reserves in the past years, an "uncontrolled exit" from the U.S. dollar as a reserve currency, especially in emerging economies, is a possible trigger of instability in currency markets." They went on to say... "Countries holding "high" dollar reserves should consider committing to selling their dollar holdings in a coordinated way over a longer period of time."

Speculation: PIMCO, the largest bond fund in the world, announced in January 2009 that they were reducing their exposure to U.S. debt. On January 6th, Bill Gross, of PIMCO, was on TV talking about U.S. Treasuries, how he would rather buy a German bund (treasury) than a U.S. Treasury, for the Fed is still implementing quantitative easing, and the ECB has begun to shrink their balance sheet. Two completely different directions for these two Central Banks.

Speculation: Kokusai Global Sovereign Open, the world's 2nd largest actively run bond fund, announced they are also going to shun U.S. Treasuries, and will be betting against the dollar in 2010.

Fact: On May 21, 2009, the UK Guardian announced: “Britain could lose its cherished top-tier credit rating that provides access to cheap borrowing on international markets after a downgrade of its economic outlook by Standard & Poor's today. The ratings agency expressed alarm about the country's ballooning budget deficit and switched its outlook from "stable" to "negative" prompting the Conservatives to issue further calls for an immediate general election.

Speculation: On Dec. 8, 2009, Moody’s Credit Rating warned that the boundaries of its sovereign ratings for the US may be tested. Clearly, the U.S. is not in the strongest position. However, it is not reached the "vulnerable" stage, and that is somewhat encouraging. However, in order for the U.S. to maintain, it needs to slow its use of debt and take steps to reduce the deficit.

Perspective: The US is moving down the exact same path as the UK.

Speculation: Morgan Stanley's chief Asian economist said Federal Reserve Chairman Ben Bernanke is prescribing 'poison' to the US economy by keeping rates near zero. In an email released December 8, 2009, the chief Asian economist said that Bernanke is fueling a wave of speculative capital that may cause the next global crisis. Bernanke is making decisions based on 'marginal considerations' that will help short term growth and employment instead of focusing on the 'soundness of the system'.

Speculation: Based on fundamentals, the U.S. Deficits will have to be addressed sooner or later. The only way to deal with the mass of debt is one of 3 things. The government can:

1. Reduce spending
2. Raise income (taxes)
3. Allow a general debasement of the currency

The reason #3 works is the preferred choice is simple… If you allow a $20 bill to be worth just $5, your debt is easier to pay down, and you have more dollars to do it with. The problem is, reason #3 is also an indirect tax on all Americans, because their real wealth also drops as the currency looses value.

Most investment professionals compare their performance to the market. This is a relative performance, in nominal terms. The real comparison should be their performance against your target rate of return, regardless of the market, while adjusting for the weakening of the dollar. This results in absolute returns in real terms.

Problem: Price is where supply meets demand. When there is a decrease in demand, price drops. When there is an increase in supply, price drops. When there is both an increase supply (increased monetary supply and monetization of debt) and a decrease in demand (by foreign central banks, oil purchases, and international trade settlement), the price drops doubly fast. If you are a U.S. citizen with all of your wealth in dollar based assets, then your real wealth will drop doubly fast, too. Granted, there might be short-term dollar rallies, as we had for 10 months in 2005, and for the 6 months from August 2008 – Feb 2009. However, the long-term trend is for a decidedly weaker dollar, based on current fundamentals, and the short-term rallies always give way to the underlying weak long-term trend.

Compounding the Problem: The traditional investment approach is based on equity, fixed income, and asset allocation models. Most people have about 20-25 years of wealth creation before they need their funds for retirement income. The March 9, 2009 DALBAR Quantitative Analysis of Investor Behavior found that for the 20 years ending December 31, 2008, equity, fixed income, and asset allocation fund investors had average annual returns of 1.87%, 0.77%, and 1.57%, respectively. The inflation rate averaged 2.89% over that same period. In real terms, each of these traditional investments approaches actually resulted in wealth destruction, rather than wealth creation, even before the loss of purchasing power due to the weaker dollar was taken into account.

Solution: To know how to protect yourself from the perils of Wall Street, the destruction of the dollar, and how to create wealth no matter what happens to the stock market, visit us at www.TheFinancialFreedomFoundation.org.

At The Financial Freedom Foundation.org we share with you the financial concepts and investment strategy necessary to create high double digit absolute returns in any economic scenario, regardless of the direction of the market or the value of the dollar. We give this information to you in a Fee Report. If you use this knowledge to become independently wealthy and retire early, we ask that you apply some of your time, funds, and "private sector" skills to relieve the suffering of others who are less fortunate: feeding the hungry, clothing the naked, liberating the captive, and administering relief to the sick and afflicted.

Potential Worst Case Scenario

Quote from Ludwig von Mises: "There is no means of avoiding the final collapse of a boom brought about by credit expansion. The alternative is only whether the crisis should come sooner as a result of a voluntary abandonment of further credit expansion, or later as a final and total catastrophe of the currency system involved."

Many countries have been devastated by unexpected debt crises, resulting in sudden economic catastrophes. The US Government could be driving our country down this path by borrowing trillions of dollars from foreign governments who do not have our best interests at heart. This gives them control over us, if they choose to stop buying our IOUs, or if they decide to suddenly sell a large percentage of the IOUs they already own, either out of spite or out of necessity. What will happen when another $1 trillion of mortgages blow up in 2010, or when $1 trillion of commercial mortgages come due in 2011, or when GE can't refinance in 2012, or when China stops buying US treasuries?

We hope that something like this never happens to the United States. For planning purposes, it is important to consider the potential ramifications of today's economic decisions. In the 16 years from 1975 to 1991, Argentina's government printed money in order to pay for its debts. The eventual inflation was so great that if it had happened in America, Bill Gate's $60 billion fortune would be worth only 60 cents. In the 1990s, the Federal Government in Thailand had accumulated so much foreign debt that by 1997, the government could no longer protect the value of its currency and within a few months, the currency lost 40% of its value, resulting in at 75% drop in the stock market and $1.5 million people lost their jobs, in a country of just 65 million people. In Zimbabwe, the government printed money to pay its obligations which resulted in inflation at a rate that prices doubled every 1.3 days!

Articles to Read:

1. **The Coming Deficit Disaster**
2. **An Empire At Risk**
3. **FDIC Bank 'Problem' List Climbs to 552**
4. **Ratings Agency Downgrades Outlook for UK Economy**

This quote from the former budget director of the CBO and fellow at the Manhattan Institute, Mr. Holtz-Eakin, in his recent WSJ article titled "The Coming Deficit Disaster," sums it up pretty well:

> "The planned deficits will have destructive consequences for both fairness and economic growth. Federal deficits will crowd out domestic investment in physical capital, human capital, and technologies that increase potential GDP and the standard of living. Financing deficits could crowd out exports and harm our international competitiveness,

as we can already see happening with the large borrowing we are doing from competitors like China. The time to worry about the deficit is not next year, but now."

From Chuck Butler, President of EverBank Capital Markets,

"An increase in federal debt can be financed in three ways: borrowing from foreigners, borrowing from our own citizens or, through a roundabout process, printing money. Let's look at the prospects for each individually - and in combination.

The current account deficit - dollars that we force-feed to the rest of the world and that must then be invested - will be $400 billion or so this year. Assume, in a relatively benign scenario, that all of this is directed by the recipients - China leads the list - to purchases of United States debt. Never mind that this all-Treasuries allocation is no sure thing: some countries may decide that purchasing American stocks, real estate or entire companies makes more sense than soaking up dollar-denominated bonds. Rumblings to that effect have recently increased.

Then take the second element of the scenario - borrowing from our own citizens. Assume that Americans save $500 billion, far above what they've saved recently but perhaps consistent with the changing national mood. Finally, assume that these citizens opt to put all their savings into United States Treasuries (partly through intermediaries like banks).

Even with these heroic assumptions, the Treasury will be obliged to find another $900 billion to finance the remainder of the $1.8 trillion of debt it is issuing. Washington's printing presses will need to work overtime.

Slowing them down will require extraordinary political will. With government expenditures now running 185 percent of receipts, truly major changes in both taxes and outlays will be required. A revived economy can't come close to bridging that sort of gap.

The deficits, if unchecked, will ultimately lead the government to put the printing presses in overdrive, and we will attempt to inflate our way out of debt. This will cause the value of the US$ to drop. Buffet recently wrote a piece with the following line: 'Unchecked carbon emissions will likely cause icebergs to melt. Unchecked greenback emissions will certainly cause the purchasing power of currency to melt. The dollar's destiny lies with Congress.' "

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