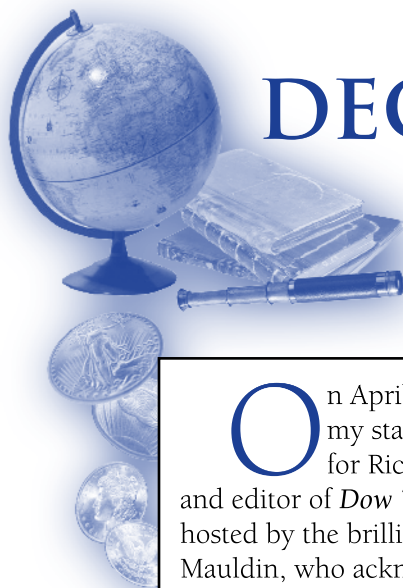

DECLARE ECONOMIC FREEDOM

A NEWSLETTER TO HELP CLEAR THE AIR OF MONETARY AND ECONOMIC CONFUSION

BY CRAIG GRIFFIN
VOLUME 1 OF 14

On April 4, 2009, along with some of my staff, I attended a tribute dinner for Richard Russell, author, publisher and editor of *Dow Theory Letters*. The tribute was hosted by the brilliant and well-respected John Mauldin, who acknowledged from the podium that Russell was his hero. Many top economic and market newsletter writers from around the world attended the dinner to honor Russell, who has been writing *Dow Theory Letters* since 1958. It is the oldest newsletter in existence today written continuously by the same author.

Through the years, I have learned more from Richard Russell than all of my teachers combined! So, of course, he is also my hero! One of the most valuable lessons I have learned from Russell is the psychology that exists at every bull market top and every bear market bottom. At the bottom of a true bear market (downtrend), we find fear and black pessimism. At the end of a bull market (rising trend), people are overly optimistic. Thank you, Russell!

INFLATION

Many years ago, Russell coined the phrase, "INFLATE OR DIE." He said it to me during an interview we conducted in 1995, and it has stuck with me ever since. What causes inflation? Wikipedia writes, **"Economists generally agree that high rates of inflation and hyperinflation are caused by an excessive growth of the money supply."** Although it is difficult right now to put a finger on the total number for the monetary and fiscal stimulus that has been injected into the system (and even harder to figure out what the final figure will be), **according to Bloomberg, as of February the Fed's commitment totaled $9.7 trillion.** In *The Aden Forecast* for May, the Adens reported that since this financial crisis began in 2007, the Federal Reserve and the government have loaned, guaranteed or spent $12.8 trillion. **I would call this "excessive growth of the money supply"!** Never, in world history, has there been such an explosion in the creation of fiat money! You can't even wrap your mind around it. It's a snowball running downhill, and it is growing larger and larger by the minute!

So, Russell was actually saying there would come a time in the history of America when the accumulation of debt would be so massive that the only way to pay it off would be to CRANK UP THE PRINTING PRESS! As I wrote in my last newsletter, "That time is here!" And we can't get away from it. Just like a person or a company, the government has to pay its debt or default (go bankrupt). Unlike our government, however, we cannot print our way out of debt!

So, what will the dollar be worth in five, 10 or 15 years from now? As my dad used to say, "That's the $64,000 question." Of course, $64,000 doesn't buy what it used to, and I think it will buy even less (actually, much less) in the not-too-distant future! Greenspan and Bernanke will likely be recorded as the greatest inflationists in Fed history!

At the time of my interview with Russell in 1995, the national debt was around $5 trillion. Today, the national debt exceeds $11 trillion and continues to increase by an average of $3.85 billion a day. Naturally, there is an interest rate attached to this debt, so the debt is also compounding. The good news is that interest rates in the U.S. have been very low for a prolonged period of time. The bad news is that interest rates in the U.S. have been very low for a prolonged period of time. Allow me to explain. At some point, interest rates are going to rise. Investors around the world hold massive amounts of investments in U.S. dollars. While our government attempts to prevent another Great Depression with its huge infusion of money for monetary stimulus and bailout programs, those heavily invested in dollars are fearful that we are creating massive inflation.

As the old tire commercial used to say, "This is where the rubber meets the road." Imagine how fast our debt will compound if interest rates rise to just 10%. Remember the Rule of 72? Under the Rule of 72, you divide the interest rate you are receiving by 72. This tells you how long it will take your money to double or, in this case, how long it will take for the debt to double. So, divide 72 by 10%. The result is 7.2 years. The last time we saw interest rates of

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10% was around 1989, when the Fed funds rate was 9.75%. Now, imagine if interest rates rise to 18%, as they did in 1980. Divide 72 by 18%. That equals four, which means the debt would double in four years. What if interest rates increase to levels even higher than they were in 1980? I think you can see the danger here. When the Fed is forced to battle inflation by raising interest rates, the debt will explode.

To sum it up, what Russell really meant, in my opinion, is INFLATE OR DEFAULT! By now it should be obvious to all of us that the Fed and the Treasury do not plan to default or go bankrupt. Since this crisis began in the summer of 2007, the Fed has gone on a monetary creation binge exceeding multitrillions of dollars, while bailing out Fannie Mae, Freddie Mac, AGI, banks and some of the auto industry.

As I said in my last newsletter, "With a gun to our heads, we have been brought to the river of money creation and thrown in to drown!" In 1971, Nixon closed the gold window. This was the final decoupling of the dollar from gold, and it opened up the possibility for central banks to print money at will. Of course, they did, in massive quantities. According to Wikipedia, "The gold standard protected citizens from hyperinflation and other abuses of monetary policy, as were seen in some other countries during the Great Depression." Isn't that what is going on today? I think it is; and, again, it has only been 38 short years since the gold standard was abandoned. In the 70s, the U.S. was a creditor nation. Yet, today the United States is the largest debtor nation the world has ever known. Today there is no discipline of the gold standard. We have to ask ourselves: "Where will it all end?"

This is why so many analysts are focused on inflation. For example, Jim Rogers, author, and world renowned investor, said the Fed is setting off an "INFLATIONARY HOLOCAUST"; Peter Schiff, president, Euro Pacific Capital, was quoted as saying we are headed for a Wiemer Republic-style inflation; and CNBC's Jim Cramer said, "I have always believed that your portfolio needs some inflationary insurance to protect you, in case we all have to trudge around like this." Cramer then moved over to a wheelbarrow loaded full with fake money, bread and a few milk cartons and said, "We don't want you to go around town with a wheelbarrow full of dollars, right, just to buy, say, a $3 million loaf of bread." Cramer then picked up another loaf of bread and said, "Now suddenly a $4 million loaf of bread, or a-four-going-to-$5 million bottle of milk. That's what happened, right!"

Cramer (as well as Schiff) was referring to Germany. Between 1919 and 1923, the German Mark was destroyed by inflation. In fact, I posted this statistic in our last newsletter. It is a dramatic demonstration of what can happen to a country's currency when inflation really begins to roll. **During January 1919, 170 German Marks would buy one ounce of gold. By November 30, 1923, it took 87 trillion (87,000,000,000,000) Marks to buy one ounce of gold. Cramer went on to say,** "Since you can't call up Allstate and buy an inflation/Wiemer Republic insurance policy, **the next best thing is to own some gold!"**

On April 15, 2009, Jim Grant, editor of the *Interest Rate Observer*, was on CNBC's *The Kudlow Report*. In that interview, Grant pointed out some truly remarkable statistics. **According to Grant, since 1929, there have been 11 recessions (depressions). On average, the fiscal and monetary response to those recessions was 2.9% of GDP. But today, the fiscal monetary response is 29% of GDP.** In other words, in relationship to GDP, the Fed is throwing 10 times as much money into this recession as any other since the Great Depression. Grant also pointed out that the recession that began in December 2007 is 1/15th the magnitude of the Great Depression. Yet, we have thrown three times the stimulus at it as we did during the Great Depression!

These analysts are just a few among many who believe that rampant inflation is very likely here in the United States. It is easy to understand why they feel this way, and I think Jim Grant said it best. So, I think it is worth summarizing again: We are throwing 10 times the average fiscal and monetary stimulus at a recession that is 1/15th the magnitude of the Great Depression! I cannot see how we can possibly escape the inflationary consequences of a banking system gone mad. It's just a matter of time, in my opinion. And, if history repeats itself — and it usually does — "smart money" (big money) will begin to look ahead for the arrival of the actual inflation and begin to buy gold prior to its arrival.

Recently, Richard Russell wrote in his newsletter that he considers gold under $1,000 an ounce as cheap! When gold hits the final phase of its bull market rise, it will be like a herd of elephants trying to get through a three-foot door. It will make what we saw during the fall of 2008 seem calm in comparison, and that was anything but calm! There is an old saying in the markets, "THERE IS NO FEVER LIKE GOLD FEVER!"

THE DOLLAR

As long-time readers know, I have been writing since the mid-1990s that the dollar would one day lose its world reserve currency status. I believe it was Ken Coleman who initially opened my eyes to that fact, but virtually no one else was writing about it at the time.

Only recently had the chorus begun to grow, but now it is coming from a full-blown choir. After years of study and much contemplation, nothing in my opinion could equal the devastation of a dollar collapse and the loss of its status as the world's reserve currency. It would most certainly be accompanied by a depression and/or hyperinflation.

What is a world reserve currency or a reserve currency? According to Wikipedia, "A **reserve currency** (or **anchor currency**) is currency which is held in significant quantities by many governments and institutions as part of their foreign exchange reserves. It also tends to be the international pricing currency for products traded on a global market, such as oil, gold, etc."

When a country or institution holds "significant quantities" of currency as their "foreign exchange reserves," they want that currency to be stable. That is why we are beginning to hear serious rumblings from around the world that the dollar should be replaced as the world's reserve currency. Since the dollar hit its peak against the Dollar Index (DI) in July 2001, it has lost over 35% to its most recent low (as of this writing), which occurred on March 17, 2008, when the dollar hit 70.69 against the DI.

At the G-20 Summit Meeting held in March 2009, the message was loud and clear: Reuters, March 30, 2009— "Beijing is pushing for more power in key institutions such as the International Monetary Fund and, more dramatically, China and Russia are both saying it is now time to consider shifting away from a dollar-dominated world."

Why should we care if the dollar loses its world reserve status? The world reserve status allows us to borrow money from other countries at a better interest rate. Therefore, as I pointed out earlier, if interest rates start to rise, our debt begins to compound faster. Also, as Russell points out in his June 8, 2009, Daily Remarks section, **"Take away the dollar's reserve status, and we can't print ourselves out of our disastrous debt situation. Why? Because without its reserve status, no other nation will accept billions of dollars!"**

So, why are China and Russia pushing for a new world reserve currency? Because they understand that debt and deficits do matter. They understand that the impact from the trillions of dollars in new fiscal and monetary stimulus into our economy is only going to further weaken the value of our dollar. According to Russell, for half a century prior to this bear market, the U.S. monetary base had been expanding at an average rate of 6%, but it has sky-rocketed at an unprecedented rate of 110%. "Within four months the Fed has doubled the monetary base. Nothing like this has ever been seen before in US history," says Russell.

It is truly unbelievable. As I have stated before, it has only been 38 years since Nixon closed the gold window. Since that time, the Federal Reserve has been on a total tear, printing money at will with no link to gold.

Many well-known and respected analysts are bearish on the U.S. dollar. James Grant, *Interest Rate Observer,* seems to be bearish on fiat currencies in general. Grant said, "We are bearish on the renminbi. On the other hand, we are also bearish on the US dollar, euro, pound, Swiss franc, and Zimbabwean dollar. We hate them all, with appropriate analytical nuances. Show us a monetary asset whose value is not subject to governmental debasement, and we will show you a Krugerrand." (A Krugerrand is a one-ounce gold piece minted in South Africa.)

Bond maven Bill Gross is also bearish on the dollar. Gross manages the biggest bond fund in the U.S. Bloomberg, June 3, 2009 **—"Bill Gross, founder of Pacific Investment Management Co., advised holders of U.S. dollars to diversify before the central banks and sovereign wealth funds ultimately do the same amid concern about surging deficits."**

If I had to listen to a higher authority regarding the dollar, it wouldn't be the Treasury Secretary or the Federal Reserve Chairman. They each have an agenda. They have to convince the rest of the world to stay in dollars. No, I would listen to the man who buys and sells the most bonds on the planet — Bill Gross! Russell also had this piece in his June 3, 2009, Daily Remarks section, which he closed by saying, "Gross advises diversifying out of dollars. The item I've suggested diversifying into is gold."

Although I am convinced that the dollar will ultimately lose its world reserve currency status, no one knows the day or the time. Could it happen tomorrow? Yes, it could. Is this the time? I don't know, but it will occur out of something that looks and feels a lot like what we have been experiencing since the credit markets froze to a standstill! To say that this is terribly troubling is an understatement! Yet, with respect to gold, the massive creation of money that began after credit markets froze in 2007 and continues — out of control — today, over the long term, I believe is going to greatly benefit the value of gold.

ECONOMY

Since we met in 2000, I have interviewed Lakshman Achuthan, managing director of the Economic Cycle Research Institute (ECRI), several times. During my

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most recent interview on April 28, 2009, Lakshman said we were in a growth cycle recovery that would lead us out of recession sometime within the next four months. Historically, when ECRI forecasts a turning point for the economy, you can take it to the bank. ECRI has accurately called the beginning and end of the 2001 recession and the beginning of this recession, which officially began in December 2007. So, I have little doubt that the U.S economy will be out of its recession by the end of summer or early fall.

The degree of the recovery, of course, is still unknown. We are in uncharted territory, experiencing the worst recession since the Great Depression -- accompanied by, or maybe I should say led by, a total collapse of the banking system. So, growth is liable to be very weak. Even the Fed is predicting a weak recovery. On Thursday, May 21, 2009, *USA Today* published an article in its Money section entitled: "**Fed sees weaker recovery this year.**" It said, "The Fed now expects the economy to contract by 1.3% to 2% this year, worse than the 0.5% to 1.3% fall it projected in January."

As a result, our economic condition is precarious at best. The economy could easily slip back into recession, as it did in the early 80s. After pulling out of what was considered a short recession in 1980, the economy tipped back into recession again in July 1981. It didn't end until November 1982. Plus, we remain vulnerable to unanticipated shocks like 9/11 and natural disasters like Hurricane Katrina. We really are in uncharted territory!

ECRI also developed a very sophisticated gauge called the Future Inflation Gauge (FIG). I have read that this gauge is closely watched as an indicator of future inflation by the Federal Reserve. For the first time in many months the FIG turned up in May and June. If this gauge turns up in a persistent, pervasive and pronounced way, we may be on the cusp of a huge dose of inflation. Why? Because of the unprecedented fiscal and monetary stimulus! This could turn into the 1970s, or even worse, with low growth and high inflation. This is known as stagflation. (If you are unfamiliar with the definition, it includes low consumer demand with high unemployment.) Remember what gold did in the 70s? It went up over 24 times its starting price. In the short term anything can happen, markets correct and go down, but I must say that I believe the stage is set for gold to go much higher over the long term!

THE STOCK MARKET

Since March 9, 2009, the Dow and the general stock market have been rising (as of this writing). Is this the beginning of a new bull market for stocks or is this a bear market rally? That's the question everyone is trying to answer.

On March 9, the Dow sank to 6,547.05; on the same day the Transportation average also hit a new low of 2,146.89. From there the Dow and the Transports headed higher at the fastest pace in history. At the time, I wrote in an ITM update that it didn't feel like a true bear market bottom to me. However, it could be.

I remember well what the bear market bottom for gold felt like. You couldn't drag people kicking and screaming to buy gold. No one wanted gold! It was August 1999, and gold was $252.20 an ounce. Nobody wanted it! It took five years before people even began to notice that the price of gold had almost doubled. That is what a bear market bottom feels like. It feels lonely and desolate. In 1982, when the Dow bottomed at 777 points, only 9.4% of the public was in the stock market. By the time we reached the dot-com bubble in 2000, 56% of the public was in the stock market; and everywhere you went all you heard about was the stock market. That's what a bull market top feels like.

Historically, true primary bear markets last 25% to 33% as long as the previous bull market. Most analysts identify the beginning of the bull market for stocks as having started in 1982. It ended in the summer of 2007. How could that be? Because we got a Dow Theory bear market signal in November 2007. According to Dow Theory, as taught through Richard Russell, once a Dow Theory bear market signal is given, you must go back in time until the last time the Dow and the Transports recorded their last joint high. That occurred on July 19, 2007, when the Dow hit 14,000.41 and the Transportation Average reached its all-time high of 5,446.48. So, the bear market for stocks actually began on July 19. That means that the bull market lasted about 25 years. Therefore, historically speaking, the bear market could last anywhere from 6.25 to 8.30 years.

Now, could the worst be over? When ECRI signals the end of a recession and the stock market turns up under Dow Theory, these are two very good market signals. **The danger is that bear market rallies can be both powerful and deceptive. It has been said many times that more money was lost during (or at the end of) the bear market rally that followed the 1929 crash than was lost in the crash itself.** Yet, if this rally becomes persistent and continues to reach new highs, one would have to say a new bull market has been born.

Most economists believe that growth in the economy will be anemic, and the stock market is a reflection of the economy. Even the Fed is forecasting a weak recovery. But as I have stated throughout this

letter, because the monetary and fiscal stimulus is unprecedented — anything seems possible.

If a new bull market for stocks has begun, it would not be a bad sign for gold. Gold's performance was stellar during the five-year bull market rally for stocks that began in October 2002 and ended in October 2007. (See the first paragraph of the Gold Section.)

GOLD

I would like to point out here that, during this bull market for gold, the biggest gains occurred in conjunction with the stock market. Using the Dow as a proxy for the stock market, let's go back and look at the figures. You may remember that the stock market rose precipitously in 1999 and early 2000. On January 14, 2000, the Dow hit an intermediate peak of 11,722.98, before sliding down (some would say crashing) to 7,286.27. That bottom was put in on October 9, 2002. Now, on that same date, the spot gold close was $319.70. Although they did not move in lockstep, both the Dow and gold headed higher. On October 9, 2007, five years later to the day, the Dow rose to 14,164.43, a gain of 48.56%. Gold reached its new all-time high — $1,002.50 — just five months later on March 14, 2008, a gain of 213.58%. Obviously, the stock market doesn't have to crash for gold to prosper.

During the early stages of the bull market, gold went up in anticipation of inflation, and it has been very desirable during the financial meltdown. Gold is in a bull market; and I believe over the long term it is going to be sought after for many reasons, including competitive currency devaluation. Countries around the world will seek to cheapen their currencies in order to compete for exporting in the global markets.

I don't try to predict how high gold will ultimately go or in what time frame it will get there. It is all going to work its way out according to the markets. Most of the analysts that predict price never set a duration of time with their prediction, because they know it will almost always be wrong when they attempt to put time and price together. That is why so many day traders fail!

Another lesson I learned from Richard Russell, many years ago, is to take a position in the bull market as early as possible, and ride it to the end. As I wrote earlier, Russell considers gold under $1,000 an ounce as cheap!

We have barely broken the old high of $850 an ounce set in January 1980. We did break that high on March 14, 2008, when gold reached $1,002.50. Once that price ($1,002.50) is broken in a persistent and decisive way, gold has no barriers to hold it back. As of this writing, we are within shouting distance of $1,002.50. So, depending upon when you read this, the March 2008 high could have been broken.

I believe that the actions of the Federal Reserve have clearly opened the door for higher gold prices over the long term. Did this just happen? No! It has been going on for years. However, the pace has now been accelerated, and it continues to gain momentum. You can't create money out of thin air without the discipline of a gold-backed currency and expect a different result.

In the medical profession, they call doctors practitioners. Well, we should call bankers practitioners as well, because they are practicing on us with new economic theories and new economic models that say debt and deficits don't matter.

In their latest experiment, they packaged mortgages into investment bundles called derivatives and sold them off by the billions or trillions (of dollars). The result has been the collapse of the banking system, as we know it. Of course, they just printed a few more trillion fiat dollars to bail out the bad banks.

Over the past several months, there were periods in which no one could purchase bullion gold. The mints were not able to keep up with demand. Some say that this is an indication that too many people were buying gold. I believe it was caused by a long bear market for gold that lasted from 1980 through 1999. This allowed the paper crowd to claim that gold was dead; that gold was a relic; that gold had no purpose; and that gold no longer served as a safe haven from economic chaos. Of course, they were wrong; and when gold demand began to pick up, mints were caught short-handed. **Gold has to be mined or dug out of the ground. Men have to labor in order to produce gold, and it has to be profitable to the company that mines it. This alone creates a bit of scarcity. But a fiat currency — that can be created 24 hours a day, seven days a week. Which would you rather have?**

I believe the recent massive printing of fiat currency has extended the bull market for gold. I also believe it will take the gold price higher than many experts previously thought. As I see it, demand hasn't even begun to heat up. I read where Agora Publishing's *Energy and Scarcity Newsletter* Editor, Byron King, estimates that less than one percent of Americans currently own some gold. I would imagine that figure will soar before the bull market peak.

At the beginning of this newsletter I wrote, "One of the most valuable lessons I have learned from Russell is the psychology that exists at every bull market top and every bear market bottom." Ironically, just before going

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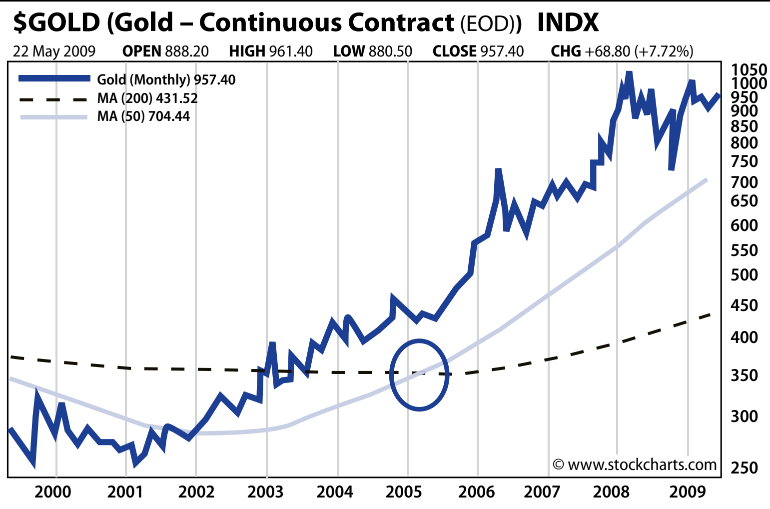
to press, Russell wrote the following "gold special" piece in his May 26, 2009, Daily Remarks section:



"Today's site is a **gold special.** The important thing to know about gold is that it is in a primary bull market [Please note it was necessary to reproduce the chart because of problems with the resolution. The crossover Russell is speaking of is circled. The 50-month moving average is blue (as in the original chart), while the 200-month moving average is dashed instead of red.]. The monthly chart shows the path of gold along with a blue 50-month moving average and a red 200-month moving average. The red arrow marks the 'golden cross-over' where the rising 50-month blue MA crossed over and above the rising red 200-month MA. The crossover occurred in May 2005. I took the monthly crossover to confirm my thesis that gold was in a **long-term primary bull market**. Note that the two moving averages have been rising ever since the crossover. Note also that, significantly, gold has held above its 50-month MA ever since the May 2005 crossover."

"Every major primary bull market takes place in three sentiment phases. The first phase of the gold bull market occurred around 1999 to 2005. This was the 'dirt cheap' phase of gold when only the true believers assumed positions. Old timers probably remember back in 2000 when I wrote that the listed gold shares were so ridiculously cheap that they could be bought and 'put away' as perpetual warrants."

"The second phase of the gold bull market started around 2005 and is still in force. This is the phase where the seasoned professionals and a few more sophisticated funds take their positions. It is in the second phase where we see the most painful secondary corrections. And it is in the second phase where the public first notices the persistent rise in gold. In the current area, gold is just starting to attract the attention of the public."

"Every major primary bull market that I have studied or lived through ends up with a wildly speculative third phase. This is the phase where the public and the crowd rushes head-long into the market. We saw this last in the years around 2000 when people bought any kind of tech stock. 'I don't care what it is, if it's tech, just get me in!'"

"My belief is that we're now nearing the beginning of the third speculative phase of the great gold bull market. The huge secondary reaction that has held gold in its grip since early 2008 is coming to an end. Interestingly, this reaction has taken the form of a large head-and-shoulders bottoming pattern. Most recently, gold has been climbing (almost unnoticed) up the formation's right shoulder. If June gold can close above 1003, I believe that will signal the beginning of gold's third speculative phase."

I think the most important thing to note from this piece is Russell's belief that gold is currently in a primary bull market and about to enter the third and speculative phase of this bull market. Although no one knows how long these phases will last, third phases are explosive and generally carry the bull market higher than anyone thinks possible.

I have presented a great deal of evidence and support as to why I believe, as many other experts do, gold is going to be the big benefactor of a Federal Reserve Banking system gone mad. The bottom line: debt and deficits are enemies of a nation's currency. We are the largest debtor nation the world has ever known, and our budget deficit will exceed last year's record by more than four times, reaching $1.8 trillion.

All bull markets move in spits and spurts, and investors must be able to hold onto their positions through the ups and downs. As I have learned from Richard Russell, the bull wants to go up with as few people on its back as possible. So, get ready for a wild ride! And, remember, "It would be foolish to acquire gold for the short term, but it would also be unwise not to own some gold for the long term."

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