Certified Gold Exchange, Inc.

ORE-VISION

Views and Analysis on the Economy and Precious Metals

A QUARTERLY NEWSLETTER

3rd QTR 2006

VOLUME 21, NO.3

What Would Happen If The USD Collapsed?

Christopher Laird

This paper looks at some kind of estimate of the economic losses/damages the world would incur if the USD went to zero next week. The conclusion is that it is inconceivable that any world central bank would *ever even think* of allowing a total USD collapse because of the financial and economic Armageddon that would follow for every nation in the world regardless of how much they like or hate the US and the USD….

Since World War 2, the USD has become the de facto world reserve currency. Right after WW2, the US had accumulated well over half the total world gold because of WW1 and WW2 arms sales to allies much of which were paid for in Gold initially. Of course, we know that the US then went to a 'Lend-Lease' policy of outright arms gifts to allies as WW2 progressed.

But After WW2, the world economies were destroyed and the USD was allowed to become the de facto world currency because we had accumulated so much gold. The other nations decided in the Breton Woods agreement to fix their currencies based on a 'gold dollar'. Until 1970, this was a de facto gold currency until Richard Nixon closed the gold convertibility of the USD. The effect was, and is, that most of the world's wealth today is inextricably tied to the USD.

At that time, the penetration of the USD worldwide was so vast that the world economy continued to base all prices of commodities, and prices, on the USD. Basically, even though the US had taken the USD completely off the gold standard, the financial mass and utility of the USD in the world economy was so powerful that the USD remained the de facto world reserve currency.

Basically, the vast majority of the world's wealth is now inextricably tied to the USD. This means that world central banks will not willingly permit its uncontrolled collapse. But there is another alternative which will be looked at in the end of this piece. That is an unforeseen or accidental financial meltdown that destroys the USD anyway.

A US treasury official in the 1970's talked to a world central banker about the banker's complaints that the US had a free ride, and was taking advantage of the de facto USD world currency standard. The Treasury official's response?

"Hey, it's our dollar, but it's your problem!"

Wow. No doubt the world is reliving that conversation at this time. China, Japan, Russia, the Middle East oil kingdoms, Korea, Taiwan, and all the other major industrial powers of the world today are locked in a no win situation of having to take USD's for all their goods, and having to allow the US to run ruinous fiscal and trade deficits. They really have little choice because every industrial and commercial process from banking to making TV sets is cost based in USD and paid for predominately in USD.

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Why Arab Countries Continue To Embrace The Doomed Dollar

Dr. Eckart Woertz

The dollar is to decline in value, and an exclusive currency peg to it, as in the Gulf Cooperation Council (GCC) countries, is unwise. Given the accumulated US deficits and imbalances in international trade, this analysis is such a no-brainer that reiterations of it, including those by my humble self, have become a bit boring. Thus, at this stage let us ask the contrarian question: why has the dollar - although stumbling - still held its ground as a worldwide reserve currency instead of falling like a stone, and why have the Gulf countries so far paid only lip service to a necessary diversification of their currency holdings?

Total US debt, including that of households and public agencies, has been ballooning since the 1980s. It now amounts to $44 trillion - 350 percent

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higher than the US' GDP. To make matters worse, most of that money is spent on consumption, while investments and jobs are moving to China and elsewhere. Thus, with a dwindling economic base, this debt has effectively become too high to be repaid. Either there will be a default in payments or, more likely, the dollar will be devalued by inflationary policies to such an extent that it will not hurt to 'pay' it back. Currently, five dollars of additional debt buy only one dollar of GDP growth, the net asset position of the US has been increasingly negative since 1985, and the trade deficit has spiraled out of control. There is no doubt that the US dollar is financial radioactive waste, and it is not really clear why anybody would like to hold it or tie their fate to this doomed currency. And yet, the US, which needs to attract 80 percent of worldwide savings to finance its current account deficit, still manages to do so. Rather than worldwide investors being suicidal, this is a problem of size and a lack of alternatives. When you have a debt of one million, you have a problem, but when you have a debt of one billion, your bank has a problem - the latter does not want to write off its assets, and will continue to throw good money after bad, just to keep you afloat. That is the position of the US, which is well aware of it; John Conolly, treasury secretary in the Nixon Administration, put it bluntly in 1971 when the US decoupled the dollar from gold: "The dollar is our currency but their problem."

After the oil shock of the 1970s, the OPEC countries were awash with cash and were obvious candidates to balance the US deficit. Saudi Arabia, in particular, was courted by the US

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To get to the point: What would happen if the USD system collapsed?

Wouldn't every industrial process, banking transaction, retirement fund, manufacturing process stop dead for a time?

Wouldn't that mean that the world economies would have to endure a major depression and financial collapse because the oil in the world financial machine (the USD) ran dry?

Wouldn't there be massive shortages, as just in time manufacturing for everything under the sun stopped cold because the USD financial payments for everything from commodities inputs to worker paychecks, to truck drivers, to fuel payments for trucks became worthless?

Would the world have to find a new way to clear *every financial transaction* from a paycheck to even a box of pencils for a factory? Find out how to clear the entire mass of USD transactions that encodes every thing that is *made, paid, invested - every second everywhere...*

In the event the USD collapses the entire world economy stops cold. And then consider the fact that just in time manufacturing means that the entire supply of every thing has about 3 days inventory, and if factories have trouble making payments to suppliers for example, the factories have to stop, and 3 days later, there just aren't any more critical 'XXX' (you fill in the blank).

Imagine every USD denominated bank account becoming worthless. Imagine trillions of dollars of retirement funds becoming worthless. Imagine China losing 2/3 of its trillion dollar foreign reserves - and Japan, and Russia, and Taiwan, and Korea.

I have tried to guesstimate the total amount of USD denominated wealth in the world. IE the total amount of everything that has *become irreversibly tied to a USD* since Breton Woods:

If you were only to look at just the US - USD cash out, something like the old US M3, that figure is around $11 trillion. Then add about oh $3 trillion of USD cash foreign reserves in places like China and Japan. Of course, some of that is double counted because some of it would be considered in the old M3 figure (the old M3 figure is all USD cash and quasi cash the US has outstanding, including things like money funds).

But these figures - about $14 trillion are a small fraction of the real amount of USD assets. To really get an idea of this figure, we need to include the total value of the US stock market. Total value of the US mutual fund industry. Total value of USD denominated insurance outstanding. Total value of much of the commodities valued and the commodities exchanges and commodities trade.

I'm just broad brushing this. Also include the total value of USD loans outstanding in Real Estate if you really want to boost the calculation. Also include the total amount of USD treasury bonds. Also include the total amount of USD denominated derivatives!

General stab at listing the above:

USD real estate loans : $50 trillion
USD bond universe: $50 trillion (wild guess)
USD derivatives of every type: $300 trillion
USD valued/contracted commodities outstanding $50 trillion
USD financial instrument universe outstanding $100 trillion

USD financial obligations of the US Federal government $50 trillion; Now, this is all very broad brush and rough. But this all comes to a cool $600 trillion.

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UNCOMMON COMMON SENSE

Aubie Baltin CFP. CTA, CFA, Phd. (retired)

When the FED announced that they would no longer report M3, without doing any homework, I automatically **assumed** that they were just trying to cover up the continuation of their massive monetary expansion. What they and the rest of the world's central bankers had begun doing instead was tightening money and credit. Whenever that happens, you can rest assured a market crash always follows. I'm sorry but I blew it. And it cost me at least $500,000 not counting what I could have or should have made by doubling or tripling the shorts I had already put on and by taking a lot more of my Gold Profits (I would never short Gold). Investing is a full time job and you have all just witnessed why I no longer give investment advice. It's better that I try to educate, so that you are able to make your own informed decisions.

NEWS vs. HISTORY

First of all, let me remind you that the Market is a discounting mechanism: It discounts what is expected to happen in the future looking 6 to 18 months out.

Secondly: Today's news is not news, its history. Never forget that is why a company can report a tremendous earnings increase and still open up down 10%. What were their projections for the next quarter and next year? Did their gross sales not increase in proportion to their earnings increase or worse, were they flat? The past is over; it's only its future outlook that counts.
Thirdly: Watch out for those talking heads on TV who are just paid touts. They are all journalists who have never taken any courses in economics or finance and yet they readily presume to advise the FED Chairman, Congress and President on what should be done. They know absolutely nothing, yet because they are so good with words they are the most dangerous to your wealth and the country's health. If you just go back a few days, you will notice that the exact same piece of news (history) such as rising oil prices is used to justify why the market went down that day and up the day or week before. Watch out for them, especially now that the Bear Market has resumed. They are one way touts, so be careful; giving them a microphone is like giving a baby a loaded gun.

CHERCHEZ La FEMME

In the sleuthing business, we all know the two cardinal rules: Follow the money and/or Cherchez La Femme. In trying to decipher the direction of the markets, there is only one Rule you must never forget: FOLLOW THE MONEY. Now that we know that the world's central bankers have decided to fight inflation by shrinking the money supply and raising interest rates, taking the minimum lag effects into consideration, we have at least six months worth of Bear Markets in front of us. That doesn't mean there won't be intermittent rallies, but the trend is definitely down, so watch out. A new earning season is upon us, you can rest assured that there will be a lot more surprises to the downside. By September, the down grades and losses will be in full swing given the monetary tightening that has already started to bite.

Don't ever confuse brains with being in a BULL MARKET

You are about to see a whole bunch of hot shots, hedge fund & portfolio managers, analysts, journalists and economists among others, about to get their heads handed to them on a platter. Playing follow the leader is easy on the way up, but it doesn't work on the way down as they all try to squeeze through that one small exit at the same time. Remember Bear Markets move on average three times faster than Bull Markets. You better make sure that you don't get steamrolled by their dash for the exits; don't forget that all those hedge funds are leveraged to the eyeballs and their forced liquidation will make the sell off in gold seem like just a pothole on the road to despair.

A SOFT LANDING

Forget About It: Especially for real estate. There is no such thing as a FED engineered soft landing. Notwithstanding the 2000-2002 crash, which was not all that soft? If it wasn't for that rare confluence of events: Massive interest rate cuts in conjunction with a tremendous increase in liquidity, massive tax cuts and the beginning of a war, we would have continued on into the 21st Century's first depression. As it is, it has only been postponed for a while. The inevitable can be delayed for a short time, but it cannot be permanently stopped. All the imbalances engineered by excessively low interest rates must be resolved before the next sustained robust economy and bull market can begin.

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Funny Money

Don Stott

"In our society today, money's value is measured by what it can buy--its purchasing power. The Massachusetts Bay Colony issued the first paper money in the colonies in 1690. Other colonies soon followed suit to meet the high demand for money fueled by trade between the colonies and the scarcity of coin (which was the common form of money up to this date). Some of this early money was readily accepted, but some was not redeemed in gold or silver as promised and thus depreciated rapidly." Federal Reserve Bank of San Francisco release. Gee Dad, I wonder why it "depreciated rapidly?" Of course! Because "it was not redeemable in gold or silver as was promised." Want more official statements?

"To finance the Revolutionary War, the Continental Congress in 1775 authorized the limited issuance of paper currency. These notes, called Continentals, were denominated in dollars and backed by the "anticipation of future tax revenues," with no backing in silver or gold. Without solid backing along with rising inflation, the Continentals soon became worthless, thus the expression "not worth a Continental." Or as George Washington put it, "A wagon load of currency will hardly purchase a wagon load of provisions." The remnant of this experience was a deep distrust of paper money which was not issued again by the federal authorities until the Civil War when the federal government first issued paper money." Also Federal Reserve Bank of San Francisco.

The 'money' became worthless because it was not redeemable nor backed by gold or silver, by their own admission. This is from the printed page of the Federal Reserve, not my opinion. Of course it is my opinion, as I have been writing for many years now. They admit that past currencies, as issued by THEM, became worthless because of a lack of backing or being redeemable in gold or silver.

The piece goes on and on, telling about

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CORRECTION 2006

This time it will be much worse, beginning with Real Estate. With 40% of the homes over the last two years being owned or built for speculation, all financed by 1% or interest only ARMS mortgages, you can forget about any soft landing. Not withstanding that the average worker hasn't got a prayer of affording the averaged priced home, to whom are they going to sell all those homes to? Last year, 40% of all new mortgages were arms for second homes; because that was the only way most buyers could afford to make their monthly payments. What happens in a year when their monthly payments double or triple? Then to their chagrin, they find out that their insurance and property taxes have also doubled. If that is not bad enough, they have to start paying for their furniture and appliances and yes, even some cars that were all purchased on a buy NOW at 0% interest and start paying only next year. The exits in real estate are even smaller than in the stock and bond markets.

SARBANES OXLY

I have been warning you for almost two years now that S.O. was a disaster waiting to happen. Those idiot Socialists in Washington may have finally killed the goose that has been laying all those golden eggs. The biggest advantage that the USA had over the rest of the world was our capital markets; the ability of Entrepreneurs to raise money. That window to the public market is now just about closed to small and mid-sized companies and even large foreign corporations are now choosing to list their shares on exchanges outside the USA. Since 70% of all new jobs are created by small business, what does that portend for the future? Where do you think the recent urge to merge and/or go private comes from? That always happens at market tops, never at

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I guess I have missed about half of everything because this listing would really be about 5000 pages. I just picked some of the big items. SO let's double this figure:

$1200 trillion of USD denominated and irreversibly connected world assets and money.

All this linkage was created mostly since Breton Woods in 1944, which was created to keep cash from draining/rushing out of Europe in World War 2.

Now I want to do another modification. These values are all only the static value of these amounts. To really get an idea of what wealth would be lost to the world if the USD totally collapses, we need to include something like a capitalization for the lost yield on these assets while the world figured out how to replace the USD with some other system.

If I capitalize $1200 trillion dollars at a very conservative 5%, for say a very conservative 10 years merely to try to get back to where we were just before the USD collapsed, we have to include another 50% on top of that figure, and I am not even amortizing.

SO add at least another $600 trillion.

Now, finally, we need to look at the incalculable value of what a real world reserve currency does for financial and manufacturing efficiencies. I would say that these efficiencies the world relies on for all its business and transacting would be at least 1/3 more of the total value of the whole thing. This is probably one of the more vague things I am including in this calculation. That component comes to: Another $400 trillion. Grand Total: $2200 trillion, if these calculations make your eyes glaze over, imagine what it is doing to the world central bankers!

"the USD is our currency but it is your problem" indeed.

Ok, let's put this whole thing into perspective: If the USD collapsed to zero tomorrow, the entire world economy would stop cold, and the total loss to world wealth would be something like $2200 trillion over a period of ten years. I think this is a low estimate actually.

It would take the US with a GDP of $14 trillion a year 157 years to replace all that wealth.

It would take the world with a GDP of about $50 trillion a year 44 years to re create all that wealth.

And of course how would the US or the world earn all that back if the world economy stopped cold for about ten years in the mean time till they came up with an alternative to the USD?

This may all sound preposterous. You know, the idea that so much world wealth would disappear if the USD were to go to zero like that. However, I would like to point out that there is an event we can look at that has comparable type factors in the above calculations, not due to a currency collapse but in terms of the economic losses incurred.

That would be the Great Depression of the 1930's.

In that depression, the US and most financial markets lost about 90% of their entire market capitalization. They lost about ten years of GDP, in the case of the US alone the lost GDP was about 30%. Many other trading nations with us in that time lost more than 50% of their yearly GDP because so much economic activity stopped.

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administration to buy US securities, and was given special tranches of Treasury Bills that did not go through the normal competitive auctioning process. In the 1980s, low oil prices made the current account surpluses of OPEC countries a thing of the past and Germany and Japan stepped into the gap, with the latter obtaining the special tranches that Saudi Arabia had received in the 1970s. With German reunification and Japan's recession, the US' financiers changed once again, as the role was partly taken up by China and other emerging markets. Recently, with the resurgence in oil prices, OPEC countries have come into the spotlight again, as they have current account surpluses of approximately 35 percent of the US deficit, while the corresponding figure for Asia is 49 percent.

Recently it has indeed been the oil-exporting countries that have kept the US dollar afloat, despite occasional announcements to the contrary. Between September 2005 and April 2006, the treasury holdings of the biggest holder, Japan, declined from $672 billion to $639 billion, while the number two, China, continued to increase its holdings from $306 billion to $323 billion, but did so reluctantly, amidst calls by senior officials for currency diversification. The oil-exporting countries and the UK, however, increased their holdings massively from $66 billion to $99 billion and from $96 billion to $167 billion respectively. The increase in UK holdings has been attributed largely to Arab buying out of London.

In light of these plain numbers, GCC announcements of currency diversification appear to be mere rhetoric. The 1 percent change in Kuwait's currency peg last month was rather modest, and other GCC countries, like Saudi Arabia, Oman, and Bahrain, were quick to deny that they would follow suit in making changes to the status quo. The plan of the UAE central bank to increase its share of euros from a meager 2 percent to only 10 percent of overall currency reserves has been postponed repeatedly, and has not yet been implemented. As its announcement on the matter came shortly after the US refused to let Dubai Ports World handle the management of American ports in the wake of the P&O takeover, the announcement might have been no more than a warning of retribution. Qatar's position - holding up to 40 percent of currency reserves in euros and up to 90 percent in dollars - seems to have been the most courageous one so far, but in general, one can attest that the special relationship between the US and the Gulf countries is still intact. Most importantly, plans are still in place to peg the unified GCC currency to the US dollar in 2010. Even neighboring Iran, an outspoken advocate of diversifying in favor of the euro, and a country hardly known for its endorsement of US foreign policy, recently shunned Hugo Chavez's proposal at the OPEC summit in Caracas to price oil in euros, instead announcing that it would stick to pricing oil in dollars at its planned oil exchange on Kish Island.

Only 10 percent of GCC imports come from the US, while roughly one-third apiece comes from Europe and Asia respectively. At the same time, two-thirds of the region's energy exports go to Asia. Thus, from a trade-weighted perspective, an exclusive currency peg to the dollar does not make sense, and one could speculate about whether the GCC countries' dollar allegiance is not economic in nature, but politically motivated, as the GCC states depend heavily on the US for security in an unstable region. There are, of course, a number of economic reasons to hold on to the dollar, although they are quite different from the ones suggested by the textbook wisdom of mainstream economics. The first is that the dollar may be in bad shape, but that other currencies do not look much better. Compared to their GDPs, budget deficits in the EU are on average comparable to that of the US; Japan's is actually much higher. The only difference is the more balanced foreign trade position that the two have.

As the GDP and the number of inhabitants of Euroland are comparable to those of the US, or even surpass it, the dollar is facing real competition for the first time, in terms of transaction domain. Formerly, the thinness of markets for hard currencies like the yen, the Swiss franc, the deutsche mark, and gold limited movements out of the dollar because of the lack of sizable alternatives. However, apart from the limited political and military power of Euroland, the euro is not yet sizable enough to be an alternative - the market capitalizations of its bond and equity markets still lag far behind those of the US. It thus remains to be seen whether the euro can acquire a status as an international reserve currency on equal footing with the dollar by 2010, as expected by Nobel economic laureate Robert Mundell. This is all the more true for China - if it can avoid a hard landing for its overheated economy and develops the political and military clout to solve its growing energy problem, it might be able to become a second competitor to the dollar in 10 or 20 years. However, so far the Chinese yuan (renminbi) is not even fully convertible, and China's opaque capital markets are only a tiny fraction of the size of their American counterparts.

Thus, the dollar is illiquid because there are so many of it. For countries that want to diversify, there are simply not enough assets denominated in other currencies, and the gravity of established contractual obligations and trading platforms denominated in dollars is causing a dollar attraction, which is completely independent of the US economy and its abysmal deficit.

To grasp what is going on with the dollar, one has to look at it as a world currency that is fuelling global commerce, not as the currency of an isolated nation-state. Since its beginning in the 16th century, capitalism has always had a hegemonic power that has acted as the central banker of the world and has supplied it with the liquidity it has needed. First this was the Spaniards, then it was the Dutch, and next it was the British, once they rid themselves of Napoleon. The demise of the British pound began with World War I, and after World War II, the dollar finally took over within the framework of the Bretton Woods system. At that time, the US was by far the biggest oil producer in the world, and accounted for more than 50 percent of global industrial production. Aside from the military might of a superpower, the dollar was backed by US current account surpluses and by gold. Today, only military might is left. Since 1971, the US has essentially been paying for its imports with printed-paper, without a need to export goods and earn foreign currency or gold to pay for this. No other nation has this privilege.

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Nevertheless, the dollar debt juggernaut fuels the world economy, and everybody is happy with it. It goes without saying that the US housing and consumer markets benefit, but the Japanese love it as well - the yen carry trade has enabled them to stabilize their shaky financial system with a zero interest rate policy and without inflation. China and Southeast Asia still have not developed domestic alternatives for their export-oriented industrialization, and the Europeans are content to sail in the geopolitical and economic wake of the US.

Thus, with no clear alternative in sight, the financial health of other countries and currencies is heavily dependent on the US dollar Ponzi scheme. If the dollar goes down, they go with it, and as with the prisoner's dilemma, everybody is afraid to make the first move - the first one to abandon the dollar could set off a chain reaction that would backfire and affect them as well.

Thus, the dollar's demise might take a bit longer than common sense would suggest, as everybody is trying to evade the unpopular repercussions. Nevertheless, it is inevitable, and that is why the GCC countries need to contemplate a diversification into other currencies and gold sooner rather than later.

28 June 2006

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Funny Money

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how wonderful the printing of un-backed notes has progressed, casually mentioning that the South and North's paper money became worthless also, because they weren't backed, and were printed endlessly to pay bills for things which government had bought…usually for war. There was no welfare then, and "earmarks" hadn't been invented. Let's see now, they bought Alaska for two cents an acre, didn't they? And the Louisiana Purchase from France was for a pittance too, as I remember. The feds wasted millions financing the first continental railroads, which would have been built anyway without their assistance, which turned out to be one of history's most glaring boondoggles.

Here's some more from the Federal Reserve Bank of San Francisco, which tells the rest of the story. "Since October 1, 1877, all U.S. currency has been printed by the Bureau of Engraving and Printing, which started out as a six person operation using steam powered presses in the basement of the Department of the Treasury. Now, 2,300 Bureau employees occupy twenty-five acres of floor space in two Washington D.C. buildings. The Treasury also operates a satellite printing plant in Ft. Worth, Texas. Currency and stamps are designed, engraved, and printed twenty-four hours a day on thirty high speed presses. In 1990, at a cost of 2.6 cents each, over seven billion notes worth about $82 billion were produced for circulation by the Federal Reserve System." That was 1990. Today, I am sure that the number of presses has been added to in the last 16 years, and I am sure the production of bills is well over $250 billion a year, of course "for circulation by the Federal Reserve." Please tell me what Constitutional Authority does the Federal Reserve exist? Would the Founders approve of a private bank doling out the money?

But remember, that by its own admission, (1) Previous un-backed currencies became worthless due to not being backed by gold and silver, and (2) Dollars are being printed by the billions

every day, and are not backed by a damned thing. Correction! They are backed by the "Full faith and credit of the federal government." In other words, they are backed by nothing, are being printed endlessly, and as far as the world is concerned, noting current conditions, that "full faith and credit," are woefully lacking, not that it is worth much anyway, since you can't hold it in your hands like you can gold and silver.

I wonder why, in its 1995 release quoted above, the San Francisco Federal Reserve Bank didn't put two and two together and note that since today's dollars are un-backed, and since they are being produced by a billion a day, they might well become worthless too? That isn't the half of it however. Today's world banking system doesn't need paper money, because billions are transferred in an instant by wire, and more billions are written in checks every day, with no physical bills needed to be handled or held. Think about the billions in food stamps which are printed daily, and the billions in "earmarks" which the Congressional politicos vote for and pass each week. These all place more dollars in circulation, be they printed notes, government checks, food stamps, welfare checks, or a host of other expenses paid for with un-backed paper currencies.

As "bridges to nowhere," highways, welfare, government handouts, increased numbers of government employees, new bureaucracies, new government buildings, projects, and expenses increase daily, so does the number of dollars in circulation increase. This, of course, doesn't count the interest due the privately owned Federal Reserve. The total income taxes collected, don't even cover the interest, so borrowing goes on forever, to pay the interest, plus more dollars needed to keep politicos re-elected.

Locally, two new sets of traffic lights are being installed at a cost of $650,000. They are the 'cat's pajamas,' with all sorts of timing devices, sensitivity to emergency vehicles, etc, and are all approved by the federal "DOT," or Department of Transportation (which transports nothing). I asked the engineer who is running the thing, what the feds had to do with the project. "Nothing, other than having of approve everything we do." I then asked him if the federal DOT served any useful purpose. "No." The sidewalks were newly poured recently and are really nice, with wheelchair access, etc. The federal DOT requires that they all be torn out and replaced with their specs. What will that cost in paper money which is un-backed? Plenty! For your information, the federal DOT has 59,000 employees and spends close to $60 billion a year.

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bottoms. Sarbanes Oxley, in conjunction with a flood of easy cheap money built up over the last ten years, is now looking for a home since real estate, world stock markets, commodities and bonds are now too risky. What's left? You can rest assured that once more the banks will, like every other time in the past, get left holding the bag as their loose lending practices, encouraged by both the FED and the Government, come back to bite them in the end. Besides, the deal makers at both the banks and brokerage houses get paid for making deals, as do the senior executives and none of them care whether or not the deal will succeed. If you have any doubt, just take a look at the recent tremendous increase in earnings announced by Goldman Sachs and what happened to its stock that same day. And don't feel too bad for our new Secretary of the Treasury being forced to sell his stock for $500 million right at its all time high to take a job that will pay him less than 1/100th his current salary. Just a coincidence I guess.

PE RATIOS and DIVIDENDS

Every second analyst is touting how undervalued the market is by comparing the S&P's 17 P/E to the 35+ PE of 2000; what they neglect to mention is that every other Bear Market did not bottom until the PE had dropped to less than 8; so is a 17 PE all that cheap?
Dividends on the S&P are now below 2%; during every other market low the dividend yield has been above 6%. The only time it has been lower than today in our 200 year market history was 2000-2003. No matter what other valuation ratios you use, they all give the same kind of readings. So if you think the Market is undervalued, you better think again.

GOLD

I missed a golden opportunity and I apologize for that, but nevertheless my opinion has not changed. I am continuing to hold GOLD. The inevitable can be delayed but it is still inevitable. The US Dollar must fall sharply; it cannot sustain its current valuations in the face of $800 billion trade deficits and $500 billion budget deficits. The US Dollar strength is primarily due to the fact that interest rates in the USA are so much higher than the rest of the industrialized world, especially Japan. BUT there are real limits as to how high the FED can raise rates without plunging the US, followed by the rest of the world, into Depression. As the industrialized world begins to raise their rates in their attempt to control inflation, the spreads between them and us will narrow breaking the back of the US dollar's strength and thus launching Gold into its Second phase (Wave III) of its Bull Market.

ELLIOTT WAVE ON GOLD

The first Wave of the Bull Market in Gold began at $255 in 2001 and ended at $730 in May of 2006 and was an almost perfect Elliott Wave formation with all five waves related to each other in almost perfect Elliott Wave fashion, even in the face of round the clock trading in different markets, including twice a day Fixings in London. Normally Wave #3 is the longest and strongest wave, but this time Wave 5 was not only the strongest but it contained an Extension (quite common for commodities).

EXTENSIONS: The beauty of Elliott Wave is that it is not a trend following system. There are definite relationships between waves and it can often make projections where waves should begin and end. There is a hard and fast rule regarding 5th Wave Extensions and that is "5th Waves that are extended are always doubly retraced." What that means to you is that the $730 high will be revisited either as a Wave B of a giant ABC flat or extended Wave 2 of an ongoing Bull Market or as is also possible (but not probable), Wave 2 of a new Bear Market. BUT in either case, the $730 high will be revisited. Although it's possible that Gold could still go down another $90, I doubt it. It is my educated guess using Elliott Wave that we have seen the lows of this correction and are looking at a $200 move up regardless if you are either long term Bullish or Bearish. DON'T BE LOOKING AT A GIFT HORSE IN THE MOUTH.

June 27, 2006

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Fed boosts interest rates to highest point in 5 years

The Federal Reserve hoisted interest rates to the highest point in more than five years Thursday.

Wrapping up a two-day meeting Thursday, Chairman Ben Bernanke and other Fed policymakers didn't rule out another bump in rates. But they seemed hopeful that a slowing economy would lessen pressure on prices, leaving open the question of whether more increases would be needed to declare victory in their battle against inflation.

Fed policymakers said "the extent and timing" of any additional rate increases would hinge on how inflation and economic activity unfold.

That omission – along with observations that economic growth was slowing – was viewed by some investors and economists as the fed striking a slightly less hawkish tone about the future course of interest rates.

To fend off inflation, the Fed unanimously decided on Thursday to increase its federal funds rate by one-quarter percentage to 5.25 percent.

The funds rate, the interest that banks charge each other on overnight loans, affects a variety of other interest rates charged to consumers and businesses and is the Fed's primary tool for influencing economic activity.

In response, commercial banks raised their prime lending rate – for certain credit cards, home equity lines of credit and other loans – by a corresponding amount, to 8.25 percent.

The actions left both the funds rate and the prime rate at their highest points in more than five years.

June 30, 2006

Article by:
Jeannine Aversa
The Associated Press

Funny Money

Continued from page 6

On Tuesday, a plane landed without a nose gear, because it wouldn't go down. We saw it glide and stay aloft as long as possible and then skid to a stop with sparks flying from the nose, which was dragging on the ground. It seems to me that Boeing and the airline would easily be able to determine why that nose gear didn't go down, but oh no. Nothing was to be touched until the NTSB came there and did its examination. More needless bureaucracy, costing a huge amount of un-backed dollars. If a car runs in front of a train, and the NTSB must 'examine' and declare fault.

Why can't the public put two and two together, and come up with the obvious answer, (Federal Reserve Bank of San Francisco) which issued the statements quoted above? Money eventually becomes worthless if it is un-backed, or unredeemable in gold and silver. They admit it. Dollars are redeemable in more dollars, not precious metals. There is no legal limit on how many can be placed in circulation. I am certain other columnists will write about how the Fed and Treasury are doing their utmost to keep gold and silver down, because they are a fine temperature gauge of the economy, and the thermometer is rising once again. Will they succeed? Not in my opinion. Protect yourself

June 22, 2006

Article by:
Don Stott
Colorado gold dealer

The Outstanding Public Debt

National Debt:
8,407,988,440,501,80
The estimated population of the United States is **299,012,509**
US citizen's share of this debt is
$28,119,19
The National Debt has continued to increase an average of
$1.74 billion per day
Business, Government and Financial Debt exceeds
$44 Trillion

What Would Happen If The USD Collapsed?

Continued from page 4

Hundreds of millions of people world wide literally starved for ten years, and also did I mention that WW2 cost the world about 100 million casualties, and that war had lots of its causes directly related to the Great Depression and the social and international stress it created.

Then calculate the hundreds of trillions of USD losses of capital, plants, and destroyed cities from that war, and we have a definite analog to the kind of scenario I just played out in my estimate of the economic damages / losses that would come from a USD collapse.

In short, literal and real world financial Armageddon. The US would not be the only loser.

We have already seen such kinds of losses of such magnitudes before less than 80 years ago!

So don't think this is so way out there because it is not way out, this stuff happens!

Now, I have to make one final observation. People think that world central banks would be the ones to sell/kill off the USD, IE that is the only way it can be wiped out. The scary reality is that they may not be able to stop it from happening if they wanted to stop it. The fact is, a financial accident of market dominoes could easily cause a panic rush out of the USD. In the great depression, there was flight into the USD. This time, if there is a big worldwide financial collapse/panic, there will likely be flight OUT of the USD…..The central banks might easily not be able to stop a real USD panic even if they tried concertedly.

I have written again and again that your retirement funds and investments are probably mostly in USD assets, and are subject to vaporization if a major world financial accident happens, central banks or no central banks. This might not happen for years. But we are definitely on the precipice of it.

My newsletter, the Prudent Squirrel newsletter, is a macro gold and economic analysis. It is one of the few that actually makes **macro** gold and precious metals analysis its major method. I have successfully predicted many major trend changes in the financial markets, the most recent was the call about two weeks in advance for gold's 150$ correction for subscribers. Prediction is not a goal of the newsletter, but I do make some, particularly when there are major economic/gold sea changes coming that I foresee.

Stop by and have a look.

June 24, 2006

Article by:
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ORE-VISION

Views and Analysis on the economy and Precious Metals

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

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