



## Welcome to "The Room"

### *The subscribers-only home page of Casey Research*

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Dear Readers,

It's 4:00 am, and I'm paying for the poor decision I made last night to stay late at an after-hours party at our Chicago Options & Futures Investors' Intensive... and especially for having that last scotch and soda.

"It seemed like a good idea at the time" seeps into my soggy mind as I attempt to rally the gray matter by sucking down a hotel coffee and damaging my ear drums by playing Anna Nalick's oddly appropriate and quite beautiful Breathe (2 am) too loud in the ear phones attached to my trusty Sansa MP3 player.

While the tempting mistress of the soft bed here at the Fairmont in Chicago beckons coyly, I must soldier on as the opening session of today's session kicks off in just four hours, leaving far too little time to do justice to the multitude of items of interest that have come across the wires since last communicating with you prior to heading off for an all-too-short vacation.

So, it's head down, music up, and on with the show.

## The Building Storm: Gold, the Dollar and Inflation

In the July 25 edition of these musings, I wrote the following...

One thing to keep in mind is that Darth & company are not done with oil... and that, as oil goes, so will, for a time at least, gold and other commodities. Thus, until the other jackboot drops, we may see some reflexive corrections in commodities.

If the government is able to "bully" oil down further – a big-time election year priority – then gold holders may suffer a bit of pain in here. Should that come to pass, our view is that the correction would be short lived and potentially open up a fantastic buying opportunity.

But there is no question that, for the time being, there is still a fairly strong correlation between oil and gold... and oil has a big target on its back. So, mentally prepare yourself for some downward pressure here.

Well, one could hardly fail to notice that since writing those words, gold investors have suffered a little more than a "bit of pain." More like a good kicking as gold moved down by over \$141 from the \$920 price it was trading at when I wrote that admonition.

Making assumptions is often a bad idea, but I am going to go out on a limb here and make the assumption that some of you are concerned over the latest setback in gold, the depth of which has surprised even us.

Don't be.

The evidence to support that statement would fill a telephone book at this point. Starting with the latest U.S. inflation numbers which, even using the government's own crooked calculations, rang in the last reporting period at 5.6%. Quoting John Williams of ShadowStats.com from an email I received from that organization yesterday...

Reported consumer inflation continued to surge on both a monthly and annual basis, once again topping consensus expectations. The July CPI-U jumped to a 17-year high of 5.6% in July, while annual inflation for the narrower CPI-W — targeted at the wage-earners category where gasoline takes a bigger proportionate bite out of spending — annual inflation jumped to 6.2%. The CPI-W is used for making the annual cost of living adjustments to Social Security payments. The 2009 adjustment — based on the July to September 2008 period — remains a good bet to top 5%, more than double last year's 2.3% adjustment for 2008. Such is not good news for federal budget deficit projections.

Based on William's calculations, which use the same CPI formula used by the Fed prior to the jiggering of the Clinton years, the actual inflation rate is now running at 13.64%.

A good analogy to currency devaluation is a slow-moving hurricane that, once over warm water, gains energy.

Right now the global inflation is a huge storm, slowly circling off the proverbial coast where it is gathering strength from the hundreds of billions of dollars being fed into it by a U.S. government desperate to avoid an economic collapse... and from pricing decisions being made by everyone from manufacturers to local shopkeepers looking to cover rising costs.

At this point the skies are dark, the wind is rising, and the torrential rains are beginning to sweep in. The radio is broadcasting warnings to move to higher ground, but the hurricane has yet to hit the shore.

But when it does, it will be a Category 5 and maybe worse.

That's because, in addition to the straight-up consequences of the U.S. monetary profligacy and businesses raising prices to try and stay afloat, there is something else feeding power to the storm... something we have been warning about for years now: the rising odds that the global fiat currency system will fail.

Let me add some nuance to that remark.

In recent years, the global financial community, reflexively looking for an alternative to the obviously damaged U.S. dollar, has settled on the euro. But the euro is equally flawed, and maybe even more so, than the U.S. dollar. Now that the trading herd has also come to that conclusion, they are rushing back toward the dollar.

They are doing so not because the U.S. dollar is healthy, but rather because that is all that they know... a heads-or-tails continuum running something along the lines of "If the 'it's-not-

the-dollar' play is over, then it must be time to go back into the dollar." The euro sinks, the dollar goes up.

And so gold, viewed by these same traders only in terms of its inverse relationship to the dollar, gets hammered.

What they are missing, but not for much longer, is that rushing back into the dollar is akin to heading for the vulnerable coast, and not to the higher ground now proscribed. They are also missing the point that gold's monetary value is not limited to protecting *only* against a failure in the U.S. dollar, but against any faltering fiat currency... a moniker that the euro deserves in spades. Not only is it backed by nothing, but it is also backed by no one.

I hope that the above point is clear, because it is an important one. One way to think about it is to think about Zimbabwe. If you lived in that blighted country and a year ago you could have had an ounce of gold or a wallet full of that country's failing currency, which would have been the better bet?

The answer, while obvious, is illustrative... because the wealth preservation role that the ounce of gold would have played for a citizen of Mugabe's paradise had zero connection with how well gold did, or didn't do, against the U.S. dollar over the period.

Gold is viewed as tangible money right around the world, and has been for millennia. When the trading herd wakes up to the fact that neither the U.S. dollar nor the euro, nor any other fiat currency, will protect them against the monetary storm that will soon begin tearing the roofs off their cozy offices, they'll fall all over themselves in the rush for something that will: gold and other tangibles.

Those of you who have been with us for some time know that the scenario just described is one that we have forecasted for some time. If you think the thing through, precedent to the global monetary crisis, the euro first had to stumble. Well, it now has. The next stage -- and given the volatility of the situation, I don't think we'll have to wait long for it -- will be the realization that there is no safe fiat currency. It is at that point that the massive hurricane, a crisis of confidence in the entire fiat system, will begin ravaging the global economy in earnest.

Ambrose Evans-Pritchard of the Telegraph of London is one of only a very small handful of mainstream financial writers who sees things our way. Here's his take on the situation from an article he wrote this week, titled "Stage Two of the Gold Bull Market Is Just Beginning."

A war breaks out in the Caucasus, pitting Russia against a close ally of the United States. Inflation reaches a new peak in the euro-zone. The CPI reaches the highest in Britain since Bank of England independence. Rampant inflation sweeps the developing world.

Yet gold crashes. It has failed to deliver on its core promises as a safe-haven and inflation hedge, at least for now. Why?

Four possible answers:

1) Nobody seriously believes that Russia will overplay its hand. The world could not care less about Georgia anyway. Ergo, this is a bogus geopolitical crisis.

2) The inflation story is vastly exaggerated in the OECD core of countries that still make up 60pc of the global economy. The price of gold is already looking beyond the oil and food spike of early to mid 2008 (a lagging indicator of loose money two to three years ago) to the much more serious matter of debt-deflation that lies ahead.

3) The seven-year slide of the dollar is over as investors at last wake up to the reality that the global economy is falling off a cliff. Indeed, the US is the only G7 country that is not yet in or on the cusp of recession. (It soon will be, but by then others will be prostrate.) As an anti-dollar play, gold is finished for this cycle.

4) The entire commodity boom has hit the buffers. Looming world recession (growth below 3pc on the IMF definition) trumps the supercycle for the time being. Gold has fallen from \$1,030 an ounce in February to \$807 today in London trading. It has collapsed through key layers of technical support, triggering automatic stop-loss sales. The Goldman Sachs short-position that I have been observing with some curiosity has paid off.

For gold bugs, the unthinkable has now happened. The metal has fallen through its 50-week moving average, the key support line that has held solid through the seven-year bull market. This week is not over yet, of course. If gold recovers enough in coming days, it could still close above the line.

Courtesy of my old colleague Peter Brimelow -- whose columns on gold are a must-read -- note that Australia's Privateer point and figure chart has also broken its upward line for the first time since 2002:

<http://www.the-privateer.com/chart/gold-pf.html>

This is serious technical damage.

So have we reached the moment when gold bugs must start questioning their deepest assumptions? Have they bought too deeply into the "dollar-collapse/M3 monetary bubble" tale, ignoring all the other moving parts in the complex global system? Nobody wants to be left holding the bag all the way down to the bottom of the slide, long after the hedge funds have sold out.

Well, my own view is that gold bugs should start looking very closely at something else: the implosion of Europe. (Japan is in recession too.)

Germany's economy shrank by 1 percent in Q2. Italy shrank by 0.3 percent. Spain is sliding into a crisis that looks all too like the early stages of Argentina's debacle in 2001. The head of the Spanish banking federation today pleaded with the European Central Bank for rescue measures to end the credit crisis.

The slow-burn damage of the over-valued euro is becoming apparent in every corner of the eurozone. The ECB misjudged the severity of the downturn, as executive board member Lorenzo Bini-Smaghi admitted today in the Italian press. By raising interest rates into the teeth of the storm last month, Frankfurt has made it that much more likely that parts of Europe's credit system will seize up as defaults snowball next year.

As readers know, I do not believe the eurozone is a fully workable currency union over the long run. There was a momentary "convergence" when the currencies were fixed in perpetuity, mostly in 1995. They have diverged ever since. The rift between North and South was not enough to fracture the system in the first post-EMU downturn, the dotcom bust. We have moved a long way since then. The Club Med bloc is now massively dependent on capital inflows from North Europe to plug their current account gaps: Spain (10 percent), Portugal (10 percent), Greece (14 percent). UBS warned that these flows are no longer forthcoming.

The central banks of Asia, the Mideast, and Russia have been parking a chunk of their \$6 trillion reserves in European bonds on the assumption that the euro can serve as a twin pillar of the global monetary system alongside the dollar. But the euro is nothing like the dollar. It has no European government, tax, or social security system to back it up. Each member country is sovereign, each fiercely proud, answering to its own ancient rhythms.

It lacks the mechanism of "fiscal transfers" to switch money to depressed regions. The Babel of languages keeps workers pinned down in their own country. The escape valve of labour mobility is half-blocked. We are about to find out whether EMU really has the levels of political solidarity of a nation, the kind that holds America's currency union together through storms.

My guess is that political protest will mark the next phase of this drama. Almost half a million people have lost their jobs in Spain alone over the last year. At some point the feeling of national impotence in the face of monetary rule from Frankfurt will erupt into popular fury. The ECB will swallow its pride and opt for a weak euro policy, or face its own destruction.

What we are about to see is a race to the bottom by the world's major currencies as each tries to devalue against others in a beggar-thy-neighbour policy to shore up exports, or indeed simply because they have to cut rates frantically to stave off the consequences of debt-deleveraging and the risk of an outright slump.

When that happens -- if it is not already happening -- it will become clear that both pillars of the global monetary system are unstable, infested with the dry rot of excess debt.

The Fed has already invoked Article 13 (3) -- the "unusual and exigent circumstances" clause last used in the Great Depression -- to rescue Bear Stearns. The US Treasury has since had to shore up Fannie and Freddie, the world's two biggest financial institutions.

Europe's turn will come next. We will discover that Europe cannot conduct such rescues. There is no lender of last resort in the system. The ECB is prohibited by the Maastricht Treaty from carrying out direct bail-outs. There is no EU treasury. So the answer will be drift and paralysis.

When EU Single Market Commissioner Charlie McCreevy was asked at a dinner what Brussels would have done if the eurozone faced a crisis like Bear Stearns, he rolled his eyes and thanked the heavens that no such crisis had yet happened.

It will.

Gold bugs, you ain't seen nothing yet. Gold at \$800 looks like a bargain in the new world currency disorder.

Other members of the press are getting on board, witnessed by an article in the New York Times this week, titled *Living Costs Rising Fast, and Wages Are Trailing*. A quote...

The cost of living, led by the soaring cost of gasoline and food, is rising at the fastest rate since the recession of the early 1990s, the government said on Thursday, handing a de facto pay cut to the American worker.

The report, from the Labor Department, offered quantitative proof of what Americans have been feeling for months: almost everything costs more, even as they have less money to pay for it.

Prices of a wide range of common products in the Consumer Price Index were 5.6 percent higher last month than they were in July 2007, the sharpest annual increase since January 1991.

(You can read the entire article here: <http://www.nytimes.com/2008/08/15/business/economy/15econ.html> )

We all know that the price action of gold and, especially, related investments over the last year have been frustrating... to say the least. But the scenario now unfolding remains step-by-step in sync with our base case. As such, the best way to view this latest correction in the price of gold, is as a temporary setback of no real consequence from an investment perspective (unless you use it as a buying opportunity, something I'll be doing as soon as my broker gets to his desk).

The failure of the euro, on the other hand, is not just important... it is as monumental as it was inevitable.

## Some Holiday Musings

Well, I survived my holiday week in reasonably good condition, despite a trip with the family to an amusement park where, cosmonaut-like, I was strapped into something called "The Boomerang," but which, if properly advertised, would have been called "The Upside-Down, Neck-Snapping Belly Turner."

Living in a small rural town in the Northeast, I don't often come face to face with large crowds such as were in evidence at the amusement park. Now whether the crowd was representative of a larger population or amusement parks attract a certain demographic, I can't say. But what I will say is that a surprisingly large percentage of my fellow park goers displayed on their proverbial sleeves what seemed to me to be an array of past bad choices.

Most in evidence, but especially noticeable in the water park area, were the remarkable number of people with potato-sack stomachs protruding over too small bathing suits, attesting to years of deciding to go for the extra helping (compounded by poor taste). Also wildly popular with the crowd was heavy decoration with elaborate tattoos, many of which involved designs that would seemingly appeal only to practitioners of some dark art. (It is hard not to wonder whether a better use of funds than tattooing would have been to replace the missing teeth.)

But each to their own, I say, adding to no one in particular, "When in Rome..." And so I ordered up a giganto-root beer float and, sucking contently on my Crazy Straw™, grooved right in with the herd.

The sheer magnitude of visual and audible inputs received at a loud and crowded amusement park are quite overwhelming, at least to my quiet country consciousness, but one input in particular has stuck with me.

That was of a middle-aged man and his wife and young kid standing by the rental lockers which, for a sum of money, provide you with a safe place to stash your belongings while splashing around. As I was next in line to use the automated payment system, I couldn't help but overhear their conversation, in which the wife patiently but firmly urged the husband to rent the locker even though he, seeing the \$14 rental charge, resisted, finally admitting forlornly, "I can't afford to spend \$14 on a locker... we just can't afford it."

It was a heartbreaking moment in an otherwise happy day. Here was a husband and a father who had obviously extended himself to pay for the tickets to the park, forced to admit he was simply tapped out. As I stood there, an unintentional witness to this small but intensely personal moment, I couldn't help wondering just what percentage of Americans, having succumbed to the recent yesteryear promises of cheap credit, are now finding themselves in similarly dire straits?

I will be the first to admit that I have been remarkably fortunate in this life. I was born into a middle-class home and from a fairly early age understood the benefits of hard work and self-directed study. When I had less, I did with less. And on having more, I always have lived well within my means, allowing me to save for rainy days. As a result, I am fairly well positioned to get through the economic turmoil we see unfolding. But viewing the situation from my more comfortable position, I can't but help but wonder how the many who now find themselves debt-strapped, unemployed, or simply struggling to find gas money are going to manage?

I honestly can't imagine, but if humans are good at one thing, it is at surviving... testament to which is the very success of our species. And so, forced to it, people will just walk away from the debts they can no longer afford to pay, and they'll band together to demand that their government give them money. And why not? The government has already sent out \$300 billion. Why not more of the same?

For their part, if there is one certainty in life, it is that the bureaucrats will do whatever it takes to avoid social upheaval as that might damage the odds of their getting reelected.

Printing more money, and raising more taxes are a certainty.

Another observation, this from the three-hour drive to and from the park, mostly on secondary roads. The number of stores now boarded up, in town after town, was very noticeable... with a particular blight on hotels and restaurants, confirming that they are among the most fragile sort of enterprise in an economic downturn. Which helps explain why one hotel owner, clinging on to his or her livelihood by the fingernails, had posted a large sign loudly announcing it as possessing "Biker Friendly Rooms and Tavern."

I am still trying to work that one out. Is it that dirty boots are encouraged on the beds? Or that there is a nightly knife fight in ye olde tavern? Or, given that motorcycles have replaced the red convertible sports car for aging yuppies looking to relive the glory years, did the hotel

owner mean to communicate that the beds have heating pads and the tavern offers a wide selection of California white wines?

## Housing Crisis Subsiding? Not hardly.

You probably saw this news, but it's worth noting anyway. From Bloomberg...

Aug. 14 (Bloomberg) -- Bank repossessions almost tripled in July and U.S. foreclosure filings increased 55 percent from a year earlier as falling prices cut homeowner equity, accelerating the housing decline, RealtyTrac Inc. said.

Bank seizures rose 184 percent, the most since reporting began in January 2005, the Irvine, California-based seller of foreclosure data said today in a statement. More than 272,000 properties, or one in 464 U.S. households, got a default notice, was warned of a pending auction or were foreclosed on. Nevada, California and Florida had the highest rates.

"It's getting worse," Rick Sharga, RealtyTrac's executive vice president for marketing, said in an interview. "The number of properties that have been foreclosed on by the banks and still haven't sold is the highest we've ever seen."

And this...

Foreclosures could put 8.4 percent of total U.S. homeowners, or 12.7 percent of homeowners with mortgages, out of their homes, according to New York-based analysts at Credit Suisse.

Now I can't tell you sitting here, the fog of last night dissipating under the assault of three cups of coffee and a bowl of energy-boosting oatmeal, whether or not the analysts at Credit Suisse have those numbers right... but even if their number is cut in half, it would represent a very serious blow to the economy.

One interesting perspective comes from Bo Keely, a longtime friend of Doug Casey's and a fellow train hopper (literally, Bo is a practicing hobo, an occasional hobby of Doug's... go figure). You could write a book about Bo's exploits, and someday someone probably will... but in an email on the housing situation, Bo had a unique perspective I hadn't heard elsewhere and thought you'd find it of interest...

"... at least in Southern Calif., Mexicans, Asians and black Americans have risen to majority middle class, and it's their homes being foreclosed. When things get tough, their cultures, unlike whites in the Great Depression, jam families into relatives' houses. I see as much of this as vacant houses."

Because of its critical role as a lynchpin to the U.S. economy, in the next edition of **The Casey Report**, we'll have much more to say on the topic of housing. In addition to updating our base case for where U.S. housing is headed and the implications of same, we'll take a look at international real estate and present an interview with Andy Miller, the real estate pro whose speech at our Scottsdale Summit can only, in hindsight, be termed as prescient.

If you are not yet a subscriber to **The Casey Report**, this would be a very good time to take advantage of our 3-month, no-risk offer. Check it out by [clicking here now](#).

## Dangerous Politics

Louis James, the globe-trotting editor of our International Speculator, was in Georgia in Eastern Europe the week before last... just days before the Russian invasion. He was there to do a series of lectures to a group of young Georgians interested in topics related to liberty and free-market economics.

Due to the freshness of the experience, he is particularly sensitive to the Russian offensive, sending along a photo from one of his students earlier this week. I wanted to share it with you because I think it's important to face up to the destruction of war, rather than sanitize it... which is essentially what the U.S. is doing by censoring photos of dead and wounded soldiers from Iraq and Afghanistan. Out of sight, out of mind... which is, in my opinion, the polar opposite of the way these things should be handled. In any event, this from Louis...

"This photo was sent by a student I taught in Georgia a few weeks ago of neighbors in his building, a number of whom were killed. Another student saw a bomb hit the road just behind where he was driving his car."



From what I have been able to tell, there are a couple of things going on that make the Russian attack on Georgia much more important than just a run-of-the-mill shoot-up between neighbors.

For one, there is a major oil pipeline that cuts right across the center of Georgia and connects the oil wealth of the Caspian Sea to a terminal in Cyprus. The U.S. and other Western countries had planned on building more pipelines... plans that are now almost certain to be scrapped. So, as with so many of today's conflicts, energy is a component.

The following is out of Business Week...

At the core of the struggle is a vast network of actual and planned pipelines for shipping Caspian Sea oil to the world market from countries that were once part of the Soviet

empire. American policymakers working with a BP-led consortium had already helped build oil and natural gas pipelines across Georgia to the Turkish coast. Next on the drawing board: another pipeline through Georgia to carry natural gas from the eastern shore of the Caspian Sea to Austria -- offering an alternate supply to Western Europe, which now depends on Russia for a third of its energy.

But after the mauling Georgia got, "any chance of a new non-Russian pipeline out of Central Asia and into Europe is pretty much dead," says Chris Ruppel, an energy analyst at Execution, a brokerage in Greenwich, Conn. The risk of building a pipeline through countries vulnerable to the wrath of Russia is just too high.

And there is something much more important going on in this drama: the equivalent of a break-out by a Russia, which is increasingly feeling hemmed in by "strategic" U.S. moves in its backyard. In the case of Georgia, that country has been wooed by the U.S. to the point where it is now one of our strongest allies in the region. So much so that, after the U.K., it provided more troops than any other nation in support of the U.S. adventure in Iraq.

In return, the U.S. has promised all sorts of rewards, including pushing for eventual admittance into NATO. I wonder how the U.S. would react to Russia cozying up to Mexico in the same way?

Meanwhile, the U.S. has negotiated a deal with Poland, another of Russia's neighbors, to position interceptor missiles on its territory.

With the attack on Georgia, the Russians -- infused by a new sense of nationalistic pride fostered by Mr. Putin and supported by the mountains of cash the West has sent them in exchange for their oil and gas -- are saying enough is enough... drawing a line in the sand with Georgian blood.

What will the Bush administration do next?

There's no telling what the next step will be in this escalating power showdown. One thing is certain: for the foreseeable future, Russia is not going to go out of its way to be helpful to the U.S. in its many international aspirations. And, to the extent that being unhelpful suits Russia's purposes, you can expect to see that as well.

Higher oil prices help Russia, but hurt the U.S. Draw your own conclusion.

## Miscellany

**A Glimpse at What's Coming.** This from the Washington Post... "Sen. Obama outlined a plan Thursday to raise tax rates on capital gains and dividend income from 15% to 20% for individuals and families making more than \$200,000 and \$250,000, respectively. He also detailed a plan to levy payroll taxes on earnings above \$250,000 at a rate between 2% and 4%..."

Making over \$200,000 a year? You have a target on your back. Oh, and if you have some appreciated assets, you might want to take your capital gains hit this year and not next.

**Single-Issue Fanatics (SIFs).** I am all but out of time, but I did want to mention the notion of SIFs... individuals who take up arms over any number of specific issues, and then worry them to the point where politicians roll over and pass suitable legislation. SIFs are a relatively new phenomenon, at least in terms of their actually being able to get things done. From Mothers Against Drunk Driving, to the anti-smoking coalition, to global-warming types, legislators are be-set with SIFs pushing their narrow agendas, cloaked in the language of serving the greater good and protesting loudly should they not get their way. It's a topic I'll have more to say about in future issues of the Room, but did want to share the following news item with you out of the Telegraph of London...

"Britain's National Children's Bureau has issued an alert that teachers must watch children as young as three, and even babies, for signs of racism. Indications of racist attitudes, according to the bureau's 366-page guide, include "name-calling, casual thoughtless comments and peer group relationships," and such "racist" behavior should be reported, the bureau says. Specific verboten behaviors include referring to others as "those people," saying someone "smells," or toddlers who "react negatively to a culinary tradition other than their own by saying 'yuk'."

**In the next issue of [Without Borders](#)...** editors Fitzroy McLean and Simon Black will be taking a closer look at safe FOREX bets, reviewing former drug czar Barry McCaffrey's most recent visit to Afghanistan, weigh in with more analysis of the South Ossetia debacle, and detail some very specific investment opportunities in Paraguay.

## And That's It for This Week...

As I sign off hurriedly because I am supposed to be on the stage doing master of ceremonies for the event now underway, a quick glance at the screens shows me that gold is trading for just shy of \$790 and the Dow is up marginally.

The phone rang a moment ago, and it was friend and correspondent Chris Summer, a broker with the Puplava organization. He was calling to see what I had heard about the U.S. Mint suspending sales of U.S. eagle gold coins. Being ensconced in our seminar as I have been, I had heard nothing, but on taking a quick look find that the news is true. This is not the first time they have done so, so I am not going to read too much into it... but I will look around a bit more, and if I find anything important to report about this development, I'll put it in next week's edition.

So, that is my take on things this week. While I wish gold were higher, things are what they are, and we shall see what we shall see... but I remain unconcerned.

Until next week, thank you for reading and for subscribing...



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