

Welcome to "The Room"

The subscribers-only home page of Casey Research

Written: July 17, 2009

Dear Reader,

Last week I started off by discussing – with great authority, I might add – our view that the U.S. stock market and, sympathetically, commodities, were on the verge of another steep leg down.

As you can see from the chart here of the S&P 500 over the five business days, rather than hopping off a cliff, Mr. Market stubbornly decided to head to higher ground, once again proving that it's a fools game to try and pick tops or bottoms (which, in our defense, we were not – we were simply yelling "run for cover" based on the darkening clouds. As to when the next deluge will actually begin, that's anybody's guess – we're just pretty sure it's not overly far off.).



In the case of the U.S. stock market this week, the lift it received was helped along, in no small part, by widely reported comments attributed to the currently popular Prof. Nouriel Roubini in which he was purported to have said that the recession is almost over.

According to Bloomberg...

July 16 (Bloomberg) -- July 16 (Bloomberg) -- U.S. stocks rose for a fourth day, the longest streak in six weeks, as economist [Nouriel Roubini](#) said the worst of the financial crisis is over and reiterated that the recession may end this year...

Unfortunately, no one bothered to inform Prof. Roubini, who took it upon himself to respond by putting out a press release on July 17...

STATEMENT ON U.S. ECONOMIC OUTLOOK BY DR. NOURIEL ROUBINI

The following is a statement from Dr. Nouriel Roubini, Chairman of RGE Monitor and Professor, New York University, Stern School of Business:

"It has been widely reported today that I have stated that the recession will be over 'this year' and that I have 'improved' my economic outlook. Despite those reports – however – my views expressed today are no different than the views I have expressed previously. If anything, my views were taken out of context.

Summing up those views, he's still bearish and expecting a protracted "deep, U-shaped recession," with the possibility of a tepid recovery next year. Some snippets from his press release...

"I have also consistently argued – including in my remarks today – that while the consensus predicts that the US economy will go back close to potential growth by next year, I see instead a shallow, below-par and below-trend recovery where growth will average about 1% in the next couple of years when potential is probably closer to 2.75%.

"I have also consistently argued that there is a risk of a double-dip W-shaped recession toward the end of 2010, as a tough policy dilemma will emerge next year: on one side, early exit from monetary and fiscal easing would tip the economy into a new recession as the recovery is anemic and deflationary pressures are dominant. On the other side, maintaining large budget deficits and continued monetization of such deficits would eventually increase long-term interest rates (because of concerns about medium-term fiscal sustainability and because of an increase in expected inflation) and thus would lead to a crowding out of private demand."

Sounds a lot like our oft-discussed "rock and a hard place" scenario. For the record, his prescription to head off the worst is for the government to unleash even more funny money, er, I mean stimulus. That view is one we expect Msrs. Obama, Rangel, and Frank, et al – the current shepherds of the economy – will lean toward as tough times get tougher.

Even so, as no one can actually predict the future, really, what does it matter what Prof. Roubini has to say? (Or we, for that matter?)

Surely there are hard facts rather than soft forecasts we can rely on?

Is the World Going Back to Work?

For starters, even in the early stages of an economic recovery, we should see a pick-up in international commerce, represented by rising imports and exports, as the world rolls up its sleeves and gets back to work.

To give us a sense of the flow of goods, we turn to one of the most active ports in the United States, the Port of Long Beach, California, which reports that year-over-year, through June, the number of loaded inbound containers has fallen by 27.6%... and loaded outbound containers is off by 29.2%.

And the trend is not improving: following a brief rebound in May to 121,064 outbound containers, in June that total swooned back to 114,107, the lowest level in four months.

Is America Going Back to Work?

In Roubini's press release, he also took a moment to remind readers of his less than optimistic views on the outlook for unemployment.

"...I predict a peak unemployment rate of close to 11% in 2010. Such large unemployment rate will have negative effects on labor income and consumption growth; will postpone the bottoming out of the housing sector; will lead to larger defaults and losses on bank loans (residential and commercial mortgages, credit cards, auto loans, leveraged loans); will increase the size of the budget deficit (even before any additional stimulus is implemented); and will increase protectionist pressures."

His decision to comment on unemployment may have been engendered by some of the latest (bad) news on that front.

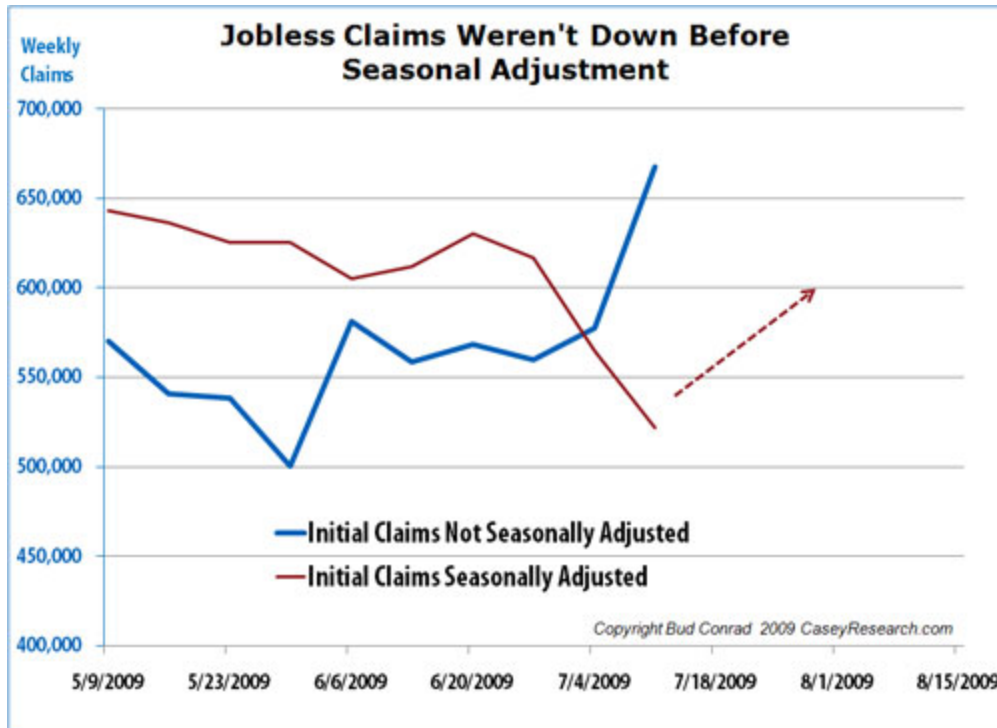
Here's a note on that topic I received this morning from our own **Bud Conrad**, whose more detailed work you can follow each month in **The Casey Report** (along with co-editors **Doug Casey**, **Terry Coxon**, and yours truly. Give it a free look for three months. [More here](#)) ...

Unemployment claims are not as good as the government makes them appear: the government makes big seasonal adjustments to the data that likely obfuscate that a lot of people actually are making new claims for unemployment. The most quoted headline number had a very big seasonal adjustment, which had the net effect of making it look like unemployment improved in the last two weeks.

On Thursday, July 16, the headline number was reported as having fallen by 47,000 for the week to 522,000. But the actual unadjusted claims were *up* 86,389 to 642,000.

Seasonal adjustment has some value, as it can help when comparing numbers week to week – for example around Christmas time, when employment increases.

Even so, it is my contention that the seasonal input may not be as applicable this year, as car makers have changed their patterns of preparation for the new models by early layoffs. Going forward, the big seasonal shift will be removed, so I would expect the headline number to jump back up even as the new claims continue to roll in. The graph shows the difference for the recent weeks.



One can only imagine that a surprise on the upside will not be well received by the ever-fickle Mr. Market.

Of course, one consequence of being unemployed, whether you are seasonally adjusted or not, is that you have a hard time paying bills – even for the really important stuff like a roof over your head.

A New Record for Foreclosures

It's hard to visualize a proper recovery in the housing sector until people stop having their houses taken away from them.

Reported Bloomberg:

July 16 (Bloomberg) -- U.S. foreclosure filings hit a record in the first half, a sign that job losses and falling property prices deepened the housing recession, according to RealtyTrac, Inc.

More than 1.5 million properties received a default or auction notice or were seized by banks in the six months through June, the Irvine, California-based seller of default data said today in a statement. That's a 15 percent increase from the year earlier. One in 84 U.S. households received a filing.

"People are losing their jobs, seeing their income go down and are underwater on their mortgage," Richard Green, director of the Lusk Center for Real Estate at the University of Southern California in Los Angeles, said in an interview. "It's a toxic combination."

In fact, according to that same article, one in eight Americans are either now late on their house payment or in actual foreclosure. When you think past the hard data to the human reality of those numbers, it's hard to be very upbeat.

After all, everyone knows that credit is hard to come by these days – therefore, being protective of one's credit score has to be of nearly paramount importance.

And yet, an increasing number of people are letting their mortgage bills get at least temporarily lost under the pile of other bills. Given the precarious state of things, that's the equivalent of pausing in the middle of a marathon to put a bullet through your foot. Sure, you might still be able to run in the race, but it's going to be a whole lot more painful.

And these are no longer just subprime borrowers: according to the Mortgage Bankers Association, "prime fixed-rate home loans to the most creditworthy borrowers accounted for 29 percent of new foreclosures in the first quarter, the biggest share of any type of loan."

As you know, dear reader, I could go on. And in fact, will.

But I must pause here to make a point: don't be fooled by the talk of economic recovery.

Yes, in time, the economy will recover – and maybe Roubini will be right in that we'll see some modest stabilization next year. At this point, however, the only thing standing in the way of outright collapse – much needed, in my view – is the promise of hundreds of billions of dollars in funny money being injected into the economy.

Don't mistake that for a solution: it's an act of desperation on the behalf of a government with no technical limits on what it can spend.

And spend they will, given they see themselves as having no other (politically acceptable) alternative. As long as CPI remains under control or is at least ignored by the broader public, they'll spend like there's no tomorrow.

(Speaking of the CPI, the June numbers released this past week rang in at 0.7% month-over-month, which is an eye-opening 8.4% annualized. Nothing to worry about, officialdom intones, "core" inflation – you know, the one that excludes non-essentials, such as food and energy -- is much lower, just 0.2%. So don't trouble your silly little head... all is well.)

Of course, U.S. inflation, which is the steady erosion in the value of our currency, is not only a domestic concern. Which brings us again to..

An Important Story

As readers of any duration know, we watch the actions of foreign holders of U.S. dollars as closely as a Las Vegas pit boss watches a card player on a \$1 million winning streak.

Many of those in the deflation camp largely, or entirely, ignore the potential role these foreign holders may play in the drama now unfolding. To bring new readers up to speed, foreigners have, over the last decade, been by far the single most important source of buying for U.S. Treasuries.

Given the Treasury's need to flog on the order of \$3 trillion worth of its unbacked paper this year just to keep the government's doors open – and that is a four- or fivefold increase over 2008 – the foreign buyers not only have to show up for the Treasury auctions, they have to show up in droves.

As you can see from the following story this week, that's not happening...

WASHINGTON (AP) – Foreign demand for long-term U.S. financial assets dropped by the largest amount in four months in May, as Japan and Russia trimmed their holdings of Treasury securities.

The Treasury Department said Thursday that foreigners actually sold \$19.8 billion more long-term U.S. securities than they purchased in May. That compared with net purchases of \$11.5 billion in April.

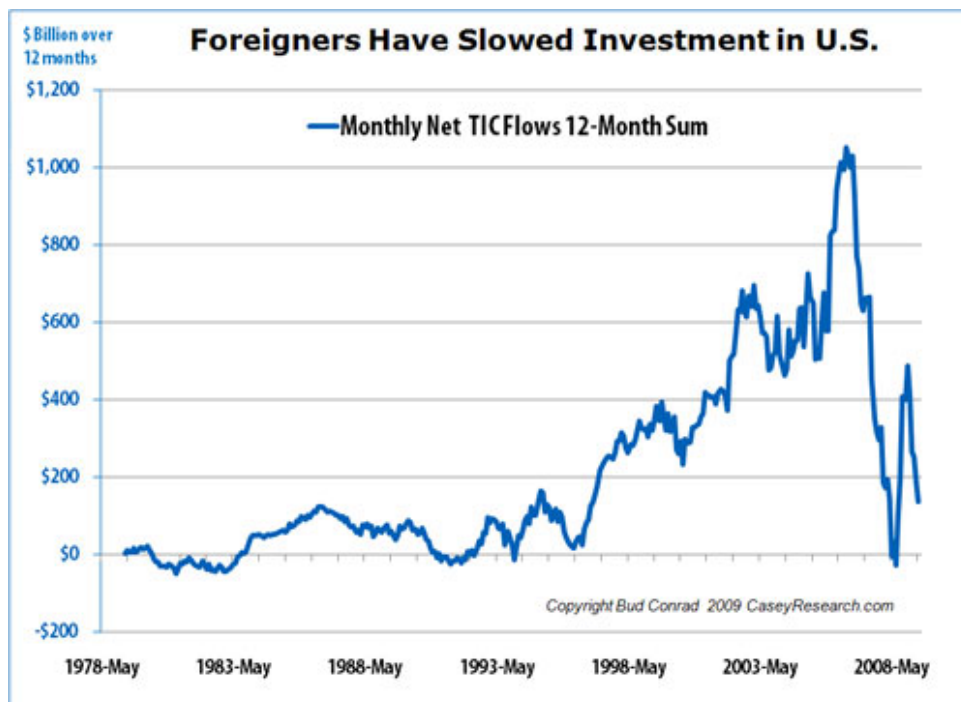
China, the largest foreign holder of U.S. Treasury securities, bucked that trend. Its holdings rose to \$801.5 billion, an increase of 5 percent from \$763.5 billion in April.

Commenting on this latest development, Bud Conrad (I increasingly wonder if Bud ever sleeps) sent around the following...

Foreign Investment in the U.S.

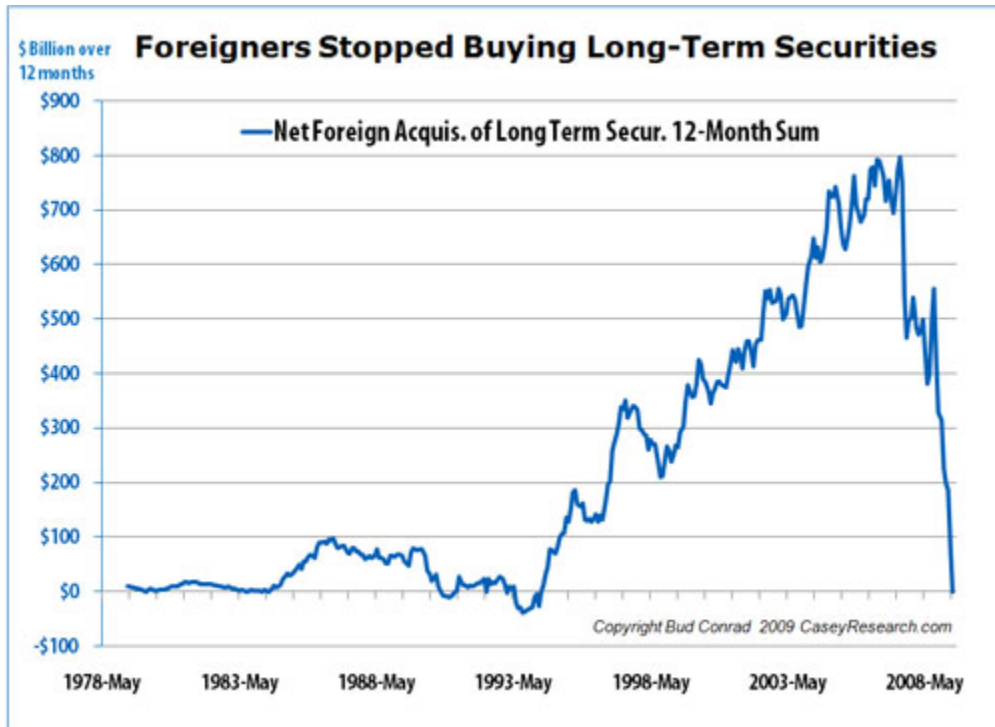
By Bud Conrad, July 16, 2009

This is the big picture of all cross-border flows as published by our Treasury. It shows both foreign investment in the U.S. and U.S. investment abroad. It includes Treasuries, agencies, corporate bonds, equities, and short-term instruments like T-bills. Foreigners bought a lot of T-bills when the credit crisis became acute. The data is published today and reports on May activity.



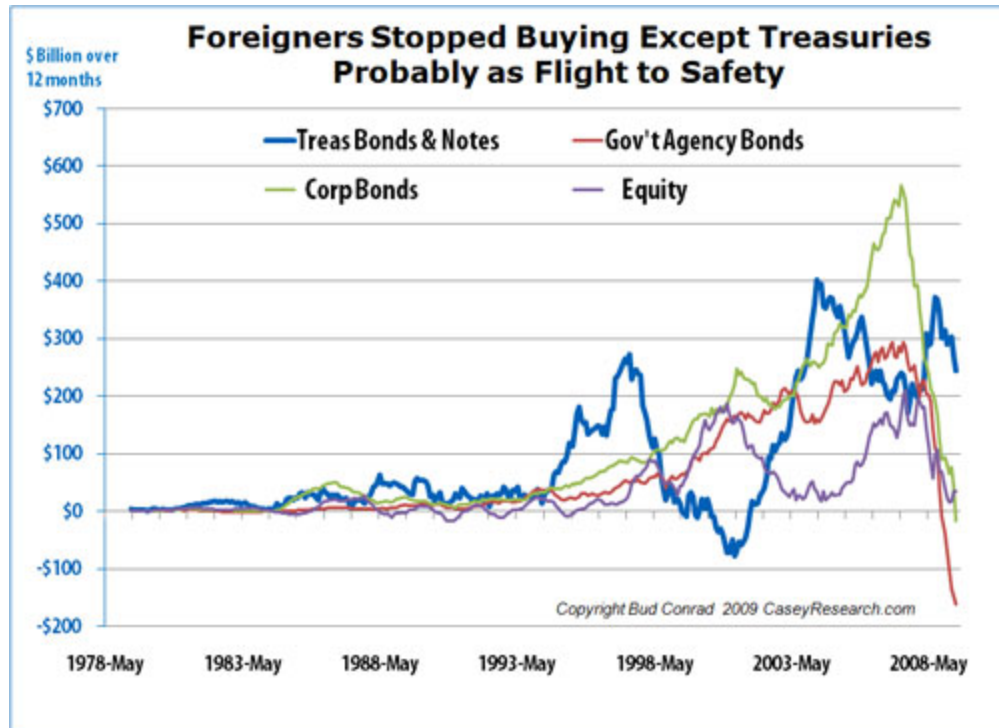
This should be a serious situation with a big drop in foreign investible funds for meeting U.S. borrowing needs. The borrowing by households and business has dropped close to zero, decreasing demand, while government borrowing has jumped but is still smaller than the private borrowing drop. The Fed has added some lending.

A look at just the longer-term Securities (not T-bills) is even more convincing of the slowing of lending by foreigners:



This decrease in credit should pressure rates higher.

And here is the breakdown of foreign investment into the U.S. Foreigners only continued to buy Treasuries, shunning new investment and selling off agencies in the riskier real estate market.



David again...

It's not for nothing that the Goldman Sachs Secretary of the Treasury Timothy Geithner is hotfooting it around the world lately, this week to Saudi Arabia and the UAE... last month to China.

In his own words, as recorded by the folks at Bloomberg, Sec Tim explained the purpose of his trip...

In Paris on Thursday, his last stop before returning to Washington, Geithner said financial leaders need to avoid the mistakes the U.S. made during the Great Depression when the government stopped providing economic stimulus before a sustained recovery was under way.

"Probably why I'm doing this (tour) is to make sure we keep working with governments around the world to continue to provide enough support to lift this global economy back to a sustained pattern of growth," he told reporters in Paris.

Translation: Look here, we're all in this together. If you jump ship now, we're all doomed... DOOMED, I say!

But the fact remains that the foreign holders of U.S. dollars have it within their ability – either deliberately or inadvertently as the result of a panic setting in – to literally destroy the U.S. currency.

The latest report shows Russia and longtime monetary ally Japan edging toward the door. China and the oil-exporting nations continue to convert an increasingly moderate amount of their trade surplus into Treasury bills – but not on a nearly large enough scale to meet the

inflated (and inflating) borrowing needs of the utterly bankrupt U.S. government. And how long will they continue to show up, when an increasing number of other foreign buyers start selling their Treasuries? No one likes to be the last one to leave a party, especially when the bananas flambé has tipped over on the floor and the curtains are on fire.

Put simply, the only thing now standing between the U.S. dollar holding its own and an almost overnight debasement (and history has shown us that when things go wrong with a currency, they can go wrong very quickly) is the willingness of foreigners to play nice. This was never a threat that the Japanese had to deal with during the worst of their recent dark days, but it's a very real risk here and now in the United States.

That that risk sits on top of the monetary inflation that has been the steady response of the U.S. government so far – and will continue to be its response as the economy further erodes – is not something to be sniffed at.

As we went to press...

July 17 (Bloomberg) -- China's finance ministry failed to meet its debt-sale target for a third time in two weeks at a 182-day bill sale, according to traders at Galaxy Securities Co. and China Citic Bank in Beijing. The ministry had tried to sell 20 billion yuan of bills and only sold 18.51 billion yuan, traders said. The average yield for the bills sold was 1.6011 percent, they said.

Bud's Take...

The problem from the Chinese government's point of view is that they were not able to borrow as much money as they wanted, in the light that they are now spending at a very fast clip with a big stimulus program to keep their own economy (bubble?) growing. So how can they fund the spending? They can sell off the stash of foreign-currency-denominated holdings they are sitting on. That could mean Treasuries dumped on the world market.

There are other alternatives, like getting the People's Bank of China to print up some new money for the government, which would inflate the renminbi (RMB) and decrease its international price and attractiveness. They might like to let the RMB fall to encourage exports and keep relative worker pay low on the world competitive scene. But they are also trying to make the RMB a world currency by itself, so they don't want it to look weak and at risk.

My guess is that they are selling Treasuries and not telling.

David again...

And there's this, from David Rosenberg, one of the few big-firm economists who got the recession right. Writing on July 17, he had this to say about the outlook for the dollar...

Is the U.S. dollar next?

It is the second anniversary of the credit crunch and after all of the fiscal and monetary policy initiatives, the best we get are “green shoots” and now that story is getting stale. Go back two years and you will see that the funds rate was 5.25%. Today it is zero. The fiscal deficit was 2.0% of GDP two years ago. Today it is 13%. Mortgage rates were 6.5%. Today they are 4.7%. Homeowner affordability with all the government measures is 70% stronger today than it was then too. The Fed's balance sheet then was \$850 billion. Today it is bloated at \$2 trillion. The government has tried just about everything. Or has it? What if we were to tell you that the one policy tool that is unchanged since the summer of 2007 is... the U.S. dollar? It is exactly the same level now, on any trade-weighted measure, as it was back then. The greenback is struggling at the 50-day moving average, and this could well be the next policy shoe to drop.

Not sure about the “policy tool” thing – they used to call it money, back when it was backed by gold.

But in this politicized world, I guess pretty much everything could be called a policy tool. Barney Frank, for instance.

Speaking of politicians who might be called tools...

A Rush to Irrelevance

As we have discussed in various communications of late, this weekly publication will become daily in the near future. More specifically, it now looks as though the new daily version – titled *Casey's Daily Dispatch* – will lift off on or about Monday, July 27.

While the idea of doing a daily column is a bit daunting, it is made less daunting by virtue of the fact that I will have help from my friends and co-workers here at Casey Research. For instance, we'll be consolidating into the Daily Dispatch some elements from other Casey e-letters, which are being discontinued as standalone services – namely Casey's Charts and the Daily Resource PLUS.

And, frankly, going to a daily publication will help alleviate the tremendous backlog of items that deserve comment but can't always be commented on in a weekly column – given the sheer volume of the news and data flying about.

For example, as I write, one of the House committees working on the health care legislation has passed a version of the plan that will cost \$1 trillion over the next 10 years – which means, in government-speak, it will actually cost four or five trillion dollars over the next 10 years. The cost for this latest bit of largess, well-meaning though it may be, will come from higher taxes on individuals and families making over \$350,000 a year – for starters.

I would like to make a prediction. A prediction, furthermore, that I intend to back up next week when I have more time and space, namely that the Obama administration is rushing to irrelevance – not unlike Jimmy Carter did in his early days in power.

The public may want health care for all, but the public is also increasingly wary of the costs. Especially when they are layered on top of other expensive new government programs, including the most recent cap-and-trade legislation, which some significant percentage of the population believes is a bad joke based on bad science.

Each president arrives in power with the winds of hope at his back and a hefty supply of political capital in his pocket. While this is especially true in the case of President Obama, it would be a mistake to think that his supply of political capital is unlimited... or even much more than normal as these things go.

And he is already starting to look as if he is running short. I have said it before, and I'll say it again: if he wants to avoid becoming a caricature of the sincere, well-meaning, but entirely ineffectual sort of president that Jimmy Carter set the standard for, he needs to get real about what's important, and fast.

To quote President Clinton, "It's the economy, stupid." (For the record, I'm not actually calling President Obama stupid, just quoting Clinton.)

To the extent that President Obama further burdens the wounded economy with massive new levels of spending, no matter how well meaning, is the extent to which he is setting himself up to preside over an inflationary catastrophe and maybe worse.

More on this topic next week. Meanwhile, since we are on the topic of bad jokes...

Out of Thin Air

By Donald Grove, Casey Research Washington Correspondent

I attended an alternative energy conference here in DC last week. I am still reeling after emerging from that surreal world in which I believe I was the only anthropogenic global warming "denier" in the room. This conference was all about the details of fighting global warming. No one ever questioned the underlying premise of this farcical boondoggle. An emissary from the UK admitted that there will be unintended consequences in carbon trading, because it is too complicated.

Unfortunately, complexity seems to tempt governments to meddle more aggressively rather than leave it to the much more capable free market to grapple with complex challenges. There were worrisome references to the "free market" in carbon credits. The emissary explained that Britain and then the EU had made mistakes with their cap-and-trade schemes but have learned from those mistakes and are adjusting accordingly.

For example, some countries in the EU need "a bit of a leg up," so those countries will get more credits but then must spend that extra money on energy efficiency. She emphasized that this is not communism, socialism, or the "nanny state." The lady doth protest too much, methinks. There seems to be a disturbing belief that these carbon credits are something valuable created out of nothing.

I am reminded of the belief that WW II pulled us out of the Great Depression. Not true. War is an expense, not a boon. Same with this made-up war against global warming. I even heard reference to creating these valuable credits "out of thin air" and then a quick correction: "out of carbon-laden air" -- an eerie parallel to the Fed and Treasury colluding to create money out of thin air. Comparisons of carbon credits to papal indulgences are apt. Go forth and sin no more! Thank God it's Friday.

Regards, Don

What I Now Know About Jewish Holidays

I recently learned that Rosh Hashanah means "Head of the Year"... that it is the first major holiday of the Jewish New Year and that it celebrates the creation of Adam and Eve.

I also learned that, in 2009, Rosh Hashanah falls on the dates of **September 18 to 20** – the very same dates of our first-ever *Casey Research Energy & Special Situations Summit* in Denver.

Of course, I wish that I had learned these facts prior to having agreed to the dates of the summit – but I didn't. I didn't check the holiday calendar, and apparently neither did anyone else.

For that oversight, I want to apologize to our Jewish subscribers.

Regrettably, the hotel will not let us out of our contract and so we cannot change the dates – which I would have done in a heartbeat – and so shall carry forward, with our sincere regrets to those whose religious beliefs will not allow them to join us.

I especially regret it, because this should be a particularly interesting get-together.

That's because we expect the energy sector to continue coming under pressure between now and the event – setting the stage for a powerful and hugely profitable rebound.

- ✓ As any investor with any real experience will attest, the absolute *worst* time to buy an energy investment is when the underlying commodity is trading at the high end of its range, as elevated prices assure maximum production – production that will eventually catch up to demand and cut the legs out from under the elevated price.

Yet, it is when prices are higher that the majority of investors catch energy fever.

No, the *real* fortunes in energy investing are made by buying when prices are dirt cheap and the shares of energy-related companies are all but spit upon by mainstream media. We are not there yet, but by September we should be.

(Ed. Note: An updated list of faculty and more [about the Summit, here.](#))

And That's It for This Week

As I sign off for the week, the stock market is flat, despite the news that there has been a bump in housing starts (another topic I'll get to next week).

After sailing close to the \$900 level over the past week, gold has again bounced back nicely and is trading at \$935.90 as I sign off.

I still think that as the next leg down in equities materializes, gold (and other commodities) will take a hit. But for reasons explained last week, I see any downdraft on that front as being fairly short lived.

For now, however, caution in all things seems wise.

Until next week, thank you for reading and for being a subscriber to a Casey Research service.

A handwritten signature in black ink, appearing to read 'DG' or similar initials, with a large, sweeping flourish above the letters.

David Galland
Managing Director
Casey Research, LLC.