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The Dollar's Descent

In the epic battle between the dollar and gold, the yellow metal is gaining the upper hand.

By Brien Lundin

It seems like every month's issue brings up a new opportunity to point out how dramatically the world of gold has changed over the preceding month.

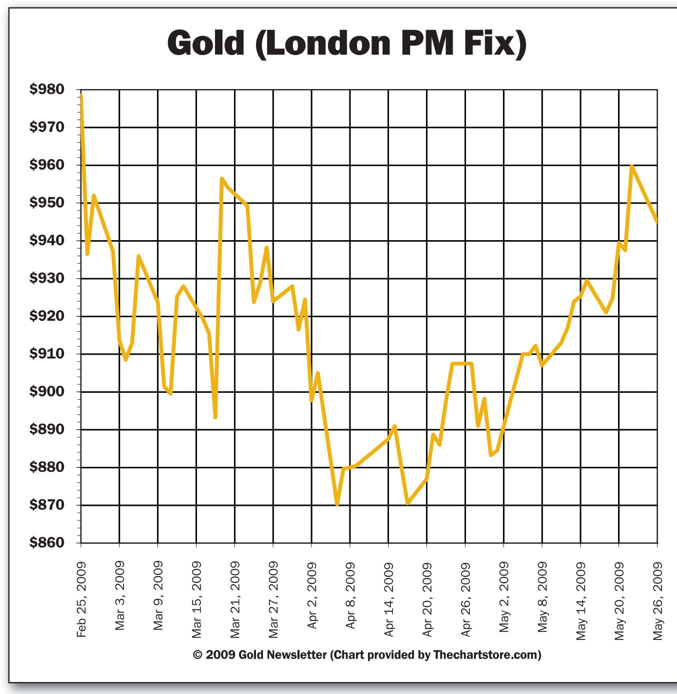
This month continues the trend, as our last issue saw us fretting over proposed IMF gold sales, concerned over the metal's inability to break out of a trading range with a low end of around $870, and wondering how the world could have so quickly forgotten about quantitative easing and the dollar destruction it would engender.

Fast-forward 30 days, and we see a gold price about $90 higher and the dollar in a free-fall.

I've often employed a seesaw analogy to illustrate the relationship between gold and the U.S. dollar. As you can see from the one-month charts of gold and the Dollar Index on the following page, it's obvious that this inverse relationship has reasserted itself over the past few weeks.

The only break in the dollar's fall has come amidst North Korea's muscle flexing in the form of a nuclear test and assorted missile launches. It's ironic that "safe haven" investing now means a flight *to* the dollar, and the return of normalcy means flight *from* the dollar.

We can take comfort in the fact that things eventually do return to normal...and today that means a far-sighted recognition of the tidal wave of dollars headed our way. But it has also come to mean something else — something that is even more disturbing than an inflation-spawned dollar destruction.



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Welcome To The United Socialist States of America

It has now become clear that the new regime in Washington is intent on inserting itself into every aspect of the economy and private business, without regard to the consequences, the rule of law, or even common sense.

It was bad enough when Congress tried to run roughshod over the law in their attempts to rescind the bonuses of AIG execs.

But then the Obama administration decided the big banks that took TARP money — some of whom never wanted or needed it in the first place — wouldn't be allowed to give it back.

Then they sacked the head of a private company (GM). Then they ignored the legal rights of secured creditors to hand over the lion's share of Chrysler to a key political supporter, the United Auto Workers union.

Then they set about to determine what is and isn't reasonable compensation for executives in the financial services industry...and no one in the White House thought the idea was the least bit controversial!

It hasn't ended there: Now we will be told what types of cars we can drive. Now we will be told, by statisticians ensconced in some shrouded Washington bureaucracy, what kind of health care we can have. And we'll be forced to pay for all of it, in fortune and lives.

Now, obviously, many Americans

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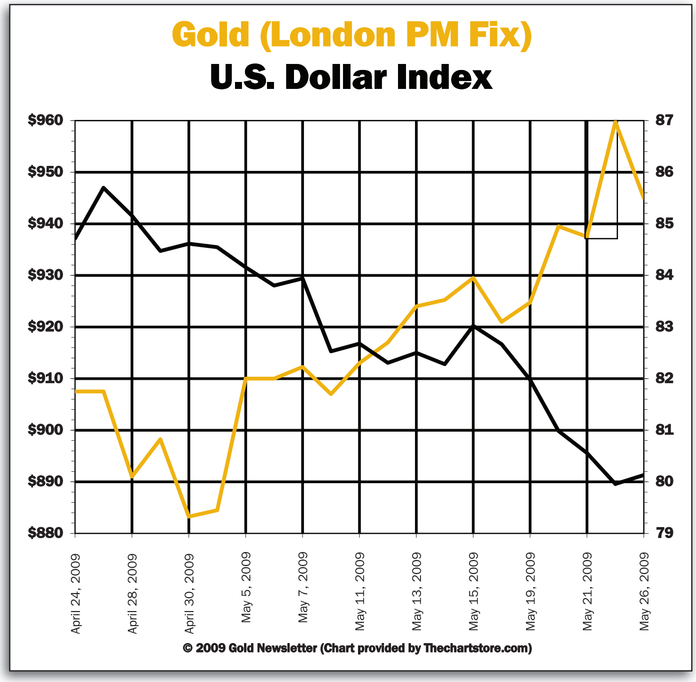

agree with these political moves. And you might be among them. But there is no argument that the U.S. government is becoming increasingly invasive in relation to the economy, the markets and private business.

And this can't be good for America's economic future.

In her weekend column on the Wall Street Journal opinion page, the always-brilliant Peggy Noonan recently commented on the dangers of this progressive shackling of our free markets.

"...Mr. Obama's government, in all its flurry of activism, may kill the goose that laid the golden egg. This is as dreadful and obvious a cliché as they come, but too bad, it's what people fear. They see the spending plans and tax plans, the regulation and reform hunger, the energy proposals and health-care ambitions, and they — we — wonder if the men and women doing all this, working in their separate and discrete areas, are being overseen by anyone saying, 'By the way, don't kill the goose.'

"The goose of course is the big, messy, spirited, inspiring, and sometimes in some respects damaging but on the whole brilliant and productive wealth-generator known as the free-market capitalist system. People do want things cleaned up and needed regulations instituted, and they don't mind at all if the very wealthy are more heavily taxed, but they greatly fear a goose killing. Economic freedom in all its chaos and disorder has kept us rich for 200 years, and allowed us as a nation to be generous and strong at home and in the world. But the goose can be killed — by carelessness, hostility, incrementalism, paralysis, and by no one saying, 'Don't kill the goose.'"

Investment Capital Is Voting With Its Feet

What does all this have to do with the dollar and gold?

Quite simply, we have to live with the consequences of the leftward tilt in American politics. But foreign capital doesn't...and it won't.

Simply put, capital flows to where it feels secure. Where free markets and the rule of law are respected.

That's why you don't see investors flocking with fat wallets to Zimbabwe. They know that their capital would be subject not to law, but to whim. In short, their funds would be quickly and efficiently confiscated.

America is not Zimbabwe, of course. But we have seen some frightening similarities in recent weeks, as pure political power has repeatedly steamrolled the rule of law.

True, as an investment venue, America doesn't present nearly the same level of risk as Zimbabwe. But it doesn't have to be that risky to send capital flying away; it only has to present more risk than the alternatives.

And America currently represents greater political risk than, say, Canada, New Zealand, Australia and Switzerland. Even France can now be regarded as friendlier to capital and wealth formation than the United States.

In a world replete with better options, it doesn't take much to send money scurrying away from America and the dollar. And that's precisely what's happening now.

As my friend and world-renowned trader Dennis Gartman (thegartmanletter.com) recently noted,

"We do indeed fear that the U.S. dollar is in jeopardy of falling materially in the coming days, weeks and months in light of the actions taken, and likely to be taken in the future, by the Obama Administration....

"In other words, the tide has shifted. In other words, the tectonic plates are moving. In other words we've no choice but to err upon the side of dollar bearishness henceforth. In other words, the game has changed, with new rules to guide us from this point forward. In other words, money will flow from the US to other harbors, and we shall say yet again that the most logical harbors are those that look the most like the U.S. but which are not suffering from the same left-wing, ill advised policies of the present Administration."

Which brings me back to the same point I've been making for months: We will have to endure a sometimes-painful transition from fear of financial catastrophe to fear of inflation. But once through it, we will see gold embark on the most powerful leg of its bull market.

From all appearances, that transition is progressing nicely.

What It All Means

Of course, the current rally in the metals is supportive of our bullish views on not only the metals, but also mining equities. In fact, as I've been noting in my weekly Alerts, there's a feeling in the air that this summer might not feature the typical seasonal market weakness.

In fact, the gold rally has sustained itself for so long now that even the most junior resource stocks are rebounding, and seem willing — at least at this point — to fight off the summer doldrums.

Editor's Note: *Gold Newsletter is the world's oldest and most respected advisory on precious metals and resource stocks. For a sample issue, including recent stock recommendations, visit goldnewsletter.com.*

Gold Newsletter
In Our 36th Year

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