

**Today's Notes:**

- 1. The Currency**
- 2. Retirement: Work Longer Pay More Taxes**
- 3. A Happy Finish for Chris Berry at the New York City Triathlon**

## **1. THE CURRENCY**

I have written frequently about the strength of the US dollar following the now infamous speech of Treasury Secretary Henry Paulson on Sunday July 13<sup>th</sup> 2008. The speech was meant to reassure China of the viability of Fannie Mae and Freddie Mac, the Government Sponsored Enterprises (GSEs). He spoke following the very visible failure on Indy Mac on July 11, 2008. China had been a large buyer of Fannie and Freddie debt in the first half of 2008 - to the tune of US\$62 billion. These purchases, in part, recycling huge trade surpluses by China kept the US housing bubble rolling uphill at breakneck speed.

China was given the "G-word" assurance from Treasury during the Paulson speech. The Bush Administration and Congress allocated \$200 billion to back Fannie and Freddie. To date (July 23, 2009), \$85.7 billion of taxpayer money has been poured into these Black Holes. The Congressional Budget Office originally estimated a \$25 million commitment to each company would be sufficient. Today we think the total investment will be well over \$200 billion by the end of the year.

Fannie Mae's government-supported management was involved in fraud throughout this period. No wonder the Chinese were leery of owning more GSE paper. Most of us have forgotten this in light of the recent Madoff shenanigans. Nevertheless US taxpayers must still come to their rescue. They are too big to fail. On February 19, 2009 new Treasury Secretary Geithner said that each entity would now be backed by \$200 billion, enough to stabilize the companies. He said,

*"Using funds already authorized by Congress for this purpose, Treasury is amending the Preferred Stock Purchase Agreements, contractual agreements between the Treasury and the conserved entities (Fannie and Freddie) designed to ensure that each company maintains a positive net worth, to \$200 billion each from their original level of \$100 billion each. The increased funding will provide forward-looking confidence in the mortgage market and enable Fannie Mae and Freddie Mac to carry out ambitious efforts to ensure mortgage affordability for responsible homeowners."*

Under the law (the Preferred Purchase Agreement) the Treasury had a \$100 billion limit to step in a purchase Fannie and Freddie's stock. The net result is that the taxpayer (the U.S. Citizen) now owns 38% of these giants.

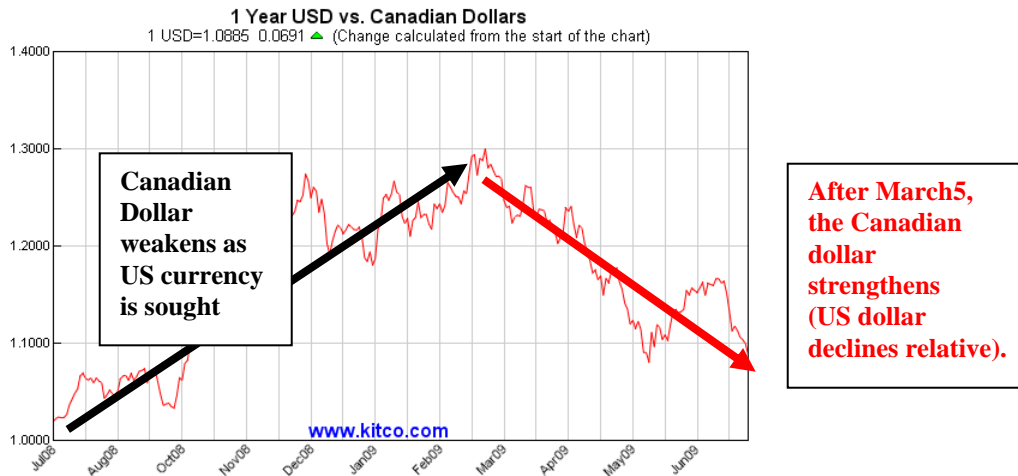
In the 1980s and 90s these stocks were on every institutional investor's list. One famous money manager continually made his performance goals on three stocks, Fannie, Freddie and Phillip Morris. What a fall from grace!

Fannie and Freddie became known as public companies whose stock was as good as the US Government's paper. But things were going dangerously wrong in the new millennium. Fannie and Freddie became aggressive at the behest of Congress. At the top, the GSEs backed 50% of the \$13 trillion US mortgage market. They also became fierce competitors overseas in marketing their mortgage paper as a substitute for Treasuries. Then at the height of US earnings hubris, 6 years of accounting scandals at the companies became public in 2006 forcing resignations, a \$400 million fine and more government oversight – obviously not enough. Fannie's management (Mr. Franklin Raines) was forced out after allegedly manipulating earnings to maximize executive payouts. China severely curtailed her purchases of GSE paper. These now will fall to the lot of the US taxpayer. Today there are still real questions.

How does the US government make China and Japan (\$800 billion in Agency paper) whole? When does the housing downturn end? What about the oncoming downturn in US commercial real estate? How do banks deal with toxic balance sheets, the PPIP is a sham? How are mortgage defaults and home foreclosures to be stemmed?

Now that Washington has made \$12.2 trillion in guarantees and unconventional lending programs of all sorts, and spent about \$2.5 trillion, what about the dollar? While dollar de leveraging in the global economies is not finished, the only way out for the US government is to competitively devalue the dollar. Since the US dollar is still the world's reserve currency, the US government will have little trouble in accomplishing this task and hence foisting its heavy debt load on the rest of the world through inflation. This will not occur in the immediate future because deflationary headwinds hold sway. Nevertheless we advise our readers to brace for the eventual inflation that must accompany such fiat money and printing press prolificacy.

Many observers feel that the Federal Reserve is already draining the system, or will drain the system effectively when the time comes, to avoid inflation and right the economic ship. This is less than likely however. The Greenspan and Bernanke Fed have proven themselves to be notoriously poor at interceding in controlling asset bubbles so why might we expect that the current leadership will anticipate exactly the right time to control the massive monetization that we must endure? In short central bankers have had a notoriously poor track record on timing decisions. To reinforce this thought have a look at the fate of a few currencies relative to the US dollar.



The Canadian dollar weakened from the July 2008 speech by Henry Paulson through March 2009. It fell to \$1.30. Not good for my buddies from Toronto who want to watch the Jays in spring training, but very good for Canada's export based economy. Then in an abrupt about face, the Canadian dollar strengthened to its current level of \$1.08. There are growing cries from Ottawa on this currency turnabout. Many now believe that the Loonie will strengthen to par and beyond.

The key element in this Morning Note is that, with the possible exception of China who has re pegged her currency, the US dollar has now declined against all others since March 7. There is **NO** pressure from Washington to force China to allow her currency to float. The US-China meetings in Washington this week will be a precursor perhaps to a new set of currency relationships. China cannot unload her US dollar exposure in the short run. However she can have a much more forceful say about how the US unloads the trillions of dollars of debt she has rung up and those that the Obama administration plans for our future in the areas of more expensive energy infrastructure and of course universal health care.

Is this dollar weakness the beginning of an attempt to inflate away the debt now burdening the US economy? Stay tuned. If so, gold and commodities have some further upside.

## 2. RETIREMENT- WHY DISCOVERY

We are likely in the next decade, to need increasing Discovery in medicine, energy, transportation, infrastructure, food and water amongst many other areas to support and enhance our lifestyle and that of the BRICS. I hope that I have made that case very clear. In short, the world is increasingly in need of Discovery. If you doubt this just look at Vice President Gore's discussions of a renewable, clean energy future. There will be many technological discoveries required for these grandiose renewable schemes. I am certain some will occur and we hope to be a part of that process.

But the first wave of Baby Boomers is beginning to count on retirement according to a report published and discussed in the NYT. 77 million baby boomers will follow. Most of these (and their Canadian counterparts) have been badly damaged by the \$5 trillion of wealth destruction that has occurred in recent months.

Here are few facts from book, "***Working Longer: the Solution to the Retirement Income Challenge.***" by Alicia Munnell and Steven Sass.

- 1) The nation's public (Soc Sec) and private (IRA's) retirement system is contracting even as life expectancy is increasing.
- 2) 19% of men and 33% of women who are 65 today will live to 90 or longer meaning support for 30 years in retirement will be required.
- 3) Today's retirees can expect Social Security to provide 39% of their incomes. Retirees in 2030 will replace only 30% of their income with the government's safety net.
- 4) In 1989 66% of American employers provided medical care. By 2006 35% of employers provided post retirement medical care. GM may have opted out last week.
- 5) Actual average saving amongst the 55 to 64 year old age group is \$60,000 in IRAs and 401Ks.

The solution, according to the authors of this Brookings Study, is to work longer and for the government to delay Social Security payments to 66 years, the average retirement age in 1962. So those who plan on retiring must stay a little longer. The authors are careful to point out that employers are also anxious to get rid of (not hire) older workers. The authors note "***as a baby boomer, I strive for the best but have learned to expect the worst.***"

That is why I firmly believe that an appropriate allocation to Discovery is crucial particularly for many Baby Boomers who will undoubtedly find themselves in this crunch. An active and diversified approach to Discovery should be considered by everyone in today's market. Please see my interview on the Gold Report web site for the Ten Point Discovery Grid.

### 3. A HAPPY FINISH TO THE NEW YORK CITY TRIATHLON YESTERDAY



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*for 5 years, for services as a consultant. We cannot attest to nor certify the correctness of any information in this note. Please consult your financial advisor and perform your own due diligence before considering any companies mentioned in this informational bulletin.*