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SENIORS/BOOMERS NEWSLETTER

"THE RETIREMENT EXPERTS"

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'Under democracy one party always devotes its chief energies to trying to prove that the other party is unfit to rule – and both commonly succeed' H.L. Mencken

YEAR	PRESIDENT	NATIONAL DEBT	DEBT/CAPITA
12/31/1981	REAGAN	$1,028,729,000,000	$4483
12/31/1982	REAGAN	$1,197,073,000,000	$5167
12/31/1983	REAGAN	$1,410,702,000,000	$6034
12/31/1984	**REAGAN**	**$1,662,966,000,000**	**$7052**
12/31/1985	REAGAN	$1,945,912,000,000	$8179
12/31/1986	REAGAN	$2,214,835,000,000	$9223
12/31/1987	REAGAN	$2,431,715,000,000	$10036
12/31/1988	REAGAN	$2,684,392,000,000	$10979
12/31/1989	BUSH	$2,952,994,000,000	$11964
12/31/1990	BUSH	$3,364,820,000,000	$13488
12/31/1991	BUSH	$3,801,800,000,000	$15077
12/31/1992	BUSH	$4,177,009,000,000	$16379
12/31/1993	CLINTON	$4,535,687,054,406	$17595
12/31/1994	CLINTON	$4,800,149,946,143	$18439
12/31/1995	CLINTON	$4,988,664,979,014	$18983
12/31/1996	CLINTON	$5,323,171,750,783	$20070
12/31/1997	CLINTON	$5,502,388,012,375	$20548
12/31/1998	CLINTON	$5,614,217,021,195	$20774
12/31/1999	CLINTON	$5,776,091,314,225	$21182
12/31/2000	CLINTON	$5,662,216,013,697	$20067
12/31/2001	BUSH	$5,943,438,563,436	$20848
12/31/2002	BUSH	$6,405,707,456,847	$22257
12/31/2003	BUSH	$7,001,312,247,818	$24115
12/31/2004	BUSH	$7,596,165,867,424	$25921
12/30/2005	BUSH	$8,170,424,541,313	$27626
12/28/2006	BUSH	$8,680,224,380,086	$29070
12/31/2007	BUSH	$9,229,172,659,218	$30603
12/31/2008	BUSH	$10,699,804,864,612	$35153
12/31/2009	OBAMA	$12,311,349,677,512	$40101
12/31/2010	OBAMA	$14,025,215,218,709	$45167
12/31/2011	OBAMA	$15,125,898,976,397	$48358

This chart gives us a 30 year-by-year report card on how the various administrations have performed in handling our debt…and the debt of future generations.

In 1981, we passed the $1 trillion dollar national debt mark for the first time in this country's history. (It took us roughly 200 years to accomplish that feat). As an encore, it took just 5 more years to add another $1 trillion to the burden. In 6 years after this event our illustrious representatives managed to tack on another $2 trillion. Thankfully for the next 8 years we only added $1 trillion. Phewff! Thank you Mr. Clinton.

So by 2000 we were starting the new millennium saddled with $5.6 trillion of national debt; meaning every man, woman and child in the United States owed $20,000. (My youngest son was born in January of 2000 and I still haven't had the heart to tell him how much money he owes).

Over the course of the next 8 years we doubled our debt from $5 to $10 trillion. (I'm starting to feel sick!). So now my poor kids owe the world $35,000. In only 3 years after this, up though the end of last year, we've actually been able to add $5 trillion more to our bar tab and now my 4 kids owe almost 50 grand each.

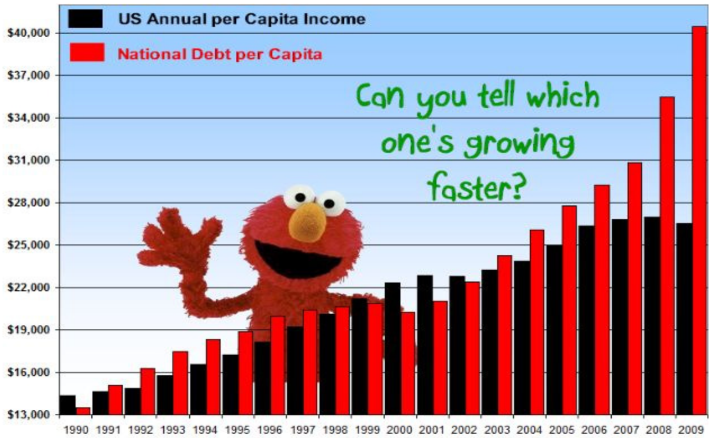
If we want to get the whole picture let's look a little way into the future. Right now, many estimates are that we should be indebted to the tune of $20 trillion by 2020 and $25 trillion by 2025.

Frankly I think the Congressional Budget Office is far too optimistic on how long it will take before we hit some of these hallucinogenic deficit figures. I believe they will come much faster than this. Their assumptions are that over the next 8 years we will see strong economic growth, low inflation, extremely low interest rates, and low unemployment. (I have some property in the Florida Everglades I'd like to talk to them about).

Personally, I would not be surprised to see us hit $20 trillion by 2016. I have determined that number through a highly precise and technical technique that I've developed known as 'guessing'. Just kidding.

There are many budgetary officials that have come up with that number and that time frame based on 'promised promises' and commitments made. At this rate we won't have long to find out who is right.

This next chart, with the assistance of Elmo, helps to illustrate how dire our condition is:



This country's per capita income is having a very hard time trying to keep a 50% pace with our spending binge. People are asking, 'what's happening to the middle class in this country'? Ask no more!

So you're probably wondering if my train of thought here has a caboose. Well, it actually does. Which lets me segue into my next article. This is about the story that neither the government nor the mainstream press is talking about: CHINA.

WHAT IT MEANS TO HAVE A 'RESERVE CURRENCY'

The United States has been blessed with possessing the title of reserve currency for most of the 20th century. That title does come with certain privileges. To begin with, it allows our government to borrow money almost 'freely' from any and all nations needing dollars to conduct international trade.

You see, most nations around the world buy oil, gold, wheat and almost every other commodity, payments for which are denominated in U.S. dollars. This has allowed our government to crank up the printing presses and just keep creating dollars because someone out there is going to buy them up. This has allowed us to live about $1.5 – $2.0 trillion/year beyond our means… for years now. We have no additional output to back up these new dollars…just a big appetite for spending.

FIGURE B3.1.1 Historical Timeline of Dominant International Currencies

Source: Classical Numismatic Group, Inc., http://www.engcoms.com.

The above chart illustrates that reserve currencies do not last forever. Great Britain and its pound sterling was the primary reserve currency for much of the 19th century and in fact, they shared that distinction with the United States, into the 20th century till up to around the end of WW2. So what happened for them to lose that title?

Several things: Britain began to lose their currency stability in the 1930's. It was then that they provided emergency support to their financial and banking systems. That was at the expense of the pound sterling, which began to lose value. When the pound lost value, people (countries) holding pounds wanted to exchange them for something else that they believed would not lose value…the U.S.dollar.

Eventually, the excess printing of pounds out-stripped demand for pounds and it began to lose even more of its value. Britain was printing pounds to cover its deficit which, in turn, expanded the supply relative to demand. You see what's going on here. A balance of payments deficit & inflation put even greater pressure on the currency until the United Kingdom finally had to devalue their currency. That was the end of the game!

The U.S. dollar became the global reserve currency because we were the most important exporter and importer of goods in the world; the economic powerhouse and world engine. Also, our dollar was as good as gold... in name, and in fact. It stayed that way until 1971 when President Nixon removed the 'gold standard' and made the dollar a fiat currency.

We had a growing 'Gross Domestic Product' to support our currency and even though the U.S. government was no longer prepared to redeem dollars for gold, the strength of our economy was enough to maintain our dominant position. When you create more than you consume you maintain a strong currency because people are buying what you're making.

Our creditors today are very worried about getting the money back that they have loaned us. At the very least they'd like to get the same value back as was loaned out. Our biggest creditor is China which holds about $3 trillion in foreign reserves. Half of this is in US currency; $1.5 trillion. That's a LOT of money.

The importance of the U.S. dollar as the reserve currency has been slipping since the 1970's. It has gone from 80% held by central banks in 1977 to roughly 66% at the beginning of 2000. It is now down to 60% and trending lower.

The Chinese have been slowly and systematically divesting themselves of dollars by buying up hard assets all over the world. Here are a few examples:

- $2.2 billion invested in shale acreage owned by Chesapeake Energy.
- $3.1 billion for a 50% stake in Argentina's Bridas Energy.
- $1 billion into Chilean copper deposits.
- $4.6 billion for 9% of ConocoPhillips.
- $7.1 billion for 40% of Spain's Repsol
- $2.2 billion for potash owned by Canpotex.
- It has invested $1.1billion in Canadian minerals.
- Over $1 billion for coal deposits in Mozambique

I'm sure you see a pattern developing here. As recently as 2007 China as a country, only had about $30 billion invested overseas. Experts predict their investments could exceed $1 trillion sometime this year.

All these billions used to go into Treasuries. They are slowly changing that. Where they used to buy $100 billion of our debt every year, they are now dividing that about 50/50 with our debt and the purchase of commodities and hard assets. The last half of 2011 saw China spend $31 billion on hard assets vs. $23 billion on Treasuries.

China is also 'colonizing' much of Africa and South America. They have been offering loans, export credits and infrastructure improvements in exchange for mining rights, and commodity delivery guarantees going out twenty years.

They have financed the presidential palace in Sudan. They loaned Ghana $10.4 billion for infrastructure projects. They also kicked in another $3 billion to develop Ghana's oil & gas sector. China also cut a barter deal with the Congo for its copper infrastructure for $6 billion. They have built pipelines across Kazakhstan and Uzbekistan and have begun mining copper south of Kabul. As the head of Citigroup Asia said, 'there's a desire to spend reserves on actual businesses rather than holding currency.

In 2010, the Chinese invested $5.6 billion in Argentina in order to form Associations that allow them to grow crops and ship them back to the mainland. Argentina is being named China's "Food Colony". They also spent $9.6 billion in Brazil for oil related products. In 2011 the numbers were: $3.5 billion into Argentina; $8.6 billion in Peru and $9.9 billion to Petrobras in Brazil on condition that Brazil supplies them with 1.5 million barrels oil/day for the next 10 years. The Chinese have also purchased oil rights in Argentina to the tune of almost $10 billion. This is some serious money!

For more than a year now, we have seen a move away from the dollar as a means of settling international trade. The Yuan already freely trades with the Euro. China has also entered into currency swap agreements with about other 20 nations, in which these countries accept each other's currency as payment for imports and exports. There are some very big ones here:

*Japan

*Brazil

*Russia

*India

*South Africa

*Hong Kong -Taiwan – South Korea –Indonesia – Malaysia – Vietnam - Thailand

*Iran - United Arab Emirates - Venezuela

*Brazil – Argentina – Belarus - Turkey

The BRICS economies (Brazil/Russia/India/China/South Africa) are home to about half the world's population and 40% of its output.

In the meantime there have been several calls to replace the U.S. dollar with something else:

-a report released by the United Nations called for abandoning the U.S. dollar as the single major reserve currency.

-Central Banks and economic groups such as the Gulf Cooperation Council have expressed a desire to set up an independent new currency to replace the dollar.

-Russia has proposed a new world currency at several G8 meetings.

-China has said, ”the world urgently needs to create a diversified currency and financial system and fair and just financial order that is not dependent on the United States”. The International Monetary Fund agrees.

In the face of these developments China has been stockpiling gold as a way of demonstrating the strength of their currency. First, being the largest gold producer in the world, they keep every last ounce for themselves. In 2011 their imports of gold in one quarter alone equaled their entire imports for 2010.

They have been busy buying ownership stakes in gold mines from around the world: Canada, Australia, South Africa, Kazakhstan, Figi, etc to the tune of over $1 billion. Most analysts think this is just the tip of the iceberg.

Paul Volker had this to say: “The growing sense around much of the world is that we have lost both relative economic strength and more important, we have lost a coherent successful governing model to be emulated by the rest of the world. Instead, we’re faced with broken financial markets, underperformance of our economy and a fractious political climate.....The question is whether the exceptional role of the dollar can be maintained." (Bloomberg)

It is generally believed that if the deficits continue to balloon as they have recently ($1.3 trillion in 2010; $1.27 trillion in 2011 and $1.1 trillion in 2012), then foreign investors and central banks will begin to lose confidence in the US's ability to manage its finances and they will begin to ditch the dollar. That will increase the cost of funding government operations by many orders of magnitude. Our interest on debt currently sits at over $200 billion per year. This is based on an average interest rate of 2.2%. What happens if rates go up to 4%? Or 5%? That’s a big chunk out of our national budget.

What are some of the man-in-the-street consequences of this? A weak dollar will virtually guarantee inflation and a sharp increase in our cost of living. Income, savings and investments are bound to suffer. Those on fixed incomes would suffer most.

The price of our imports would go up dramatically. Think oil! Interest rates would rise for you, me and of course, American businesses. Rising unemployment would be a major issue. Food prices would be affected. Because of us having the reserve currency, we have been able to borrow at the very low rates which have acted like a subsidy on everything we consume. That will change for the worst.

China has a long way to go in building liquid markets and making its financial instruments attractive to international investors. But doing so is central to Beijing's economic strategy. Chinese officials have set 2020 as the deadline for transforming Shanghai into a first-class international financial center. Their economy will by-pass the United States by 2016 to become the world’s largest. According to the Heritage Foundation, that event has already occurred.

China is moving rapidly to internationalize the Yuan, also known as the renminbi. This last year has seen a quadrupling of the share of bank deposits in Hong Kong denominated in Yuan. Seventy thousand Chinese companies are now doing their cross-border settlements in Yuan. Dozens of foreign companies have issued Yuan-denominated "dim sum" bonds in Hong Kong...among those included are McDonald’s, Caterpillar and Ford Motors. In January the Bank of China began offering Yuan-deposit accounts in New York insured by the Federal Deposit Insurance Corp.

And as the burden of debt service grows heavier, questions will be asked about whether the U.S. intends to maintain the value of its debts or might resort to inflating them away. Foreign investors will be reluctant to put all their eggs in the dollar basket. At a minimum, the dollar will have to share its safe-haven status with other currencies like the Euro and the Yuan

All these facts highlight the importance of several investment themes going forward:

1) It would be wise to have investments which are denominated in other global currencies.
2) The international & emerging markets should find a place in your portfolio.
3) Invest in the things that the BRICS nations are spending their money on.