Urgent Report

MONEY MORNING

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Why the Federal Reserve Can't Save the Dollar

Since Ben Bernanke touted the dollar's muscle in 2002, the greenback has fallen 40% against world currencies. This free report reveals what's next for the greenback and *four ways you can profit…*

Unraveling the future direction of the dollar has consistently made fools of economists and other financial gurus.

But right now, if you closely examine the history and current economic tradewinds, the clouds begin to part.

Fact is, the value of the dollar isn't just some nebulous economic macrotrend. It has a dramatic effect on your everyday life.

From the cost of food and gasoline, to interest rates on car and home loans, Americans deal with the impact of the incredible shrinking dollar in their businesses and daily lives.

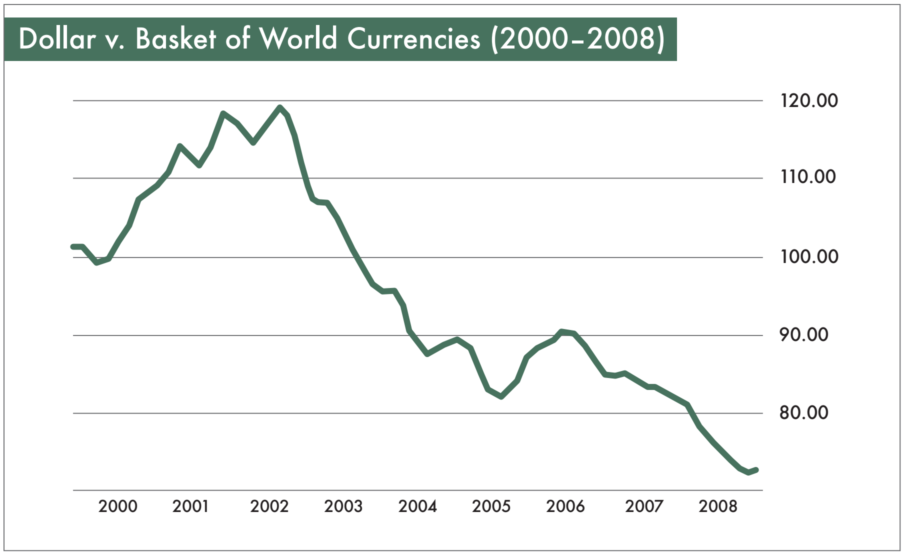
Knowing which way the dollar is headed can help your portfolio hum and let you sleep like a baby at night.

The exclusive, free report reveals how the Federal Reserve plans to save the dollar and four ways you can profit… whether the Fed succeeds or not.

Bernanke's Joke Backfires

In November 2002, Federal Reserve Chairman Ben Bernanke cracked wise in his now infamous 'Helicopter Theory' speech. When it came time to pay our debts back, he said, we could simply fire up the printing press. The world would be forced to accept our paper in lieu of those debts. If need be, the Fed **"could drop dollars from helicopters"** in order to get the money into circulation.

Unfortunately, traders around the globe didn't react kindly to his comments: Since his speech, the dollar has declined over 40% against a basket of world currencies. It's likely **we'll continue to see a steady downward trend in the dollar,** occasionally punctuated by rallies as traders take



profits. And it's unlikely our government will be able to do anything soon to stop it. Here's why:

The Fed's in a box

There are a number of factors weighing on or bouying the dollar. But Bernanke is the 300 pound gorilla in the current chess game – and his latest moves seem destined to keep the dollar in the doldrums.

The Federal Reserve, which rode boldly to the rescue in past economic slumps, can't do much this time around. Cutting interest rates, as the Fed has been doing for the last year to spur economic growth, hurts the dollar. On the other hand, raising interest rates to help the dollar would probably send the economy into a tailspin.

Then there's the economic facts of life…

The U.S. lives beyond its means, buying more than it sells. As a net debtor nation, we're running a huge trade deficit with the rest of the world, about $700 billion annually.

That's financed by foreign money inflows – mostly by foreign investors buying U.S. Treasury bonds. That leaves them holding an ever-ballooning number of U.S. dollars. Altogether, they now hold $3 trillion in government debts and liabilities.

The subprime crisis, a deteriorating stock market and consumer malaise has accelerated the greenback's slide. The overall impact, is that the global market now takes a more cautious view of the relative strength of both the U.S. economy and the dollar.

The solution, according to the currency markets, is for the dollar to sink. That would cause U.S. exports to rise as U.S. goods get cheaper for overseas buyers. In turn, U.S. imports would fall as the declining greenback makes foreign goods more expensive for U.S. consumers and businesses.

However, there's a large fly in the ointment. Having foreigners buy T-bonds inflates the money supply even as it leads to higher economic output and rising inflation.

Inflation rears its ugly head

The slowing economy has been a major concern for the Federal Reserve, prompting the central bank to make a series of interest rate cuts since last September. But the Fed has to figure out how to balance the risk of inflation against the risk of further weakness in the economy.

"Unacceptably high headline inflation has heightened the FOMC's concerns about inflation, but continuing strains in the financial markets and evidence of spreading economic softness will force the FOMC to toe a fine line between the two risks," David Resler, chief economist at Nomura Securities, wrote in a note to clients.

But, according to the government's numbers, consumer inflation rose 0.8% in June, the biggest monthly increase since February 1981.

That figure is artificially low because drastic changes have been made in how it's calculated. Food and energy are no longer even taken into account. In fact, using Consumer Price Index (CPI) calculations in effect during Clinton's presidency, the CPI would be about 6% now.

A number like that sends shivers through the Fed's bones. **You see, once inflation has entrenched itself in an economy, getting it back under control is like pulling teeth.**

But they really don't want to talk about the "I" word.

The Federal Reserve stopped reporting the M3 value, the U.S. money supply, in 2006. Best guess is it's increasing at about a 10% rate. But about $1.5 trillion of additional 'money' in bank bailouts and credit will be put into the financial system in 2008 alone.

When that much paper money is printed or electronically pumped into the credit markets you can bet your bottom dollar (excuse the pun) inflation will follow.

And that puts the main engine of the American economy, the consumer, on the defensive.

Consumers pull back

Make no mistake, consumer spending makes up about 70% of the U.S. economy. But with the foreclosure storm in full fury, and the credit crunch tightening the screws, the consumer is pulling in the reins.

So naturally, the feds are stepping up to the plate. Federal government spending rose at a real rate of 6.7% in the last quarter, while personal consumption rose only 1.5%.

Meanwhile, consumer spending is not even keeping up with income. The government recently handed out billions in tax rebates, which boosted incomes by 4% – more than twice the level of consumer spending increases.

So where does that leave the Fed? For now, in between a rock and hard place.

Any solution that would strengthen the dollar would probably involve sharply raising interest rates, increase the rate of savings, and curtail private consumption.

Don't hold your breath waiting for those kinds of measures to come to your neighborhood.

No reason to panic…yet

Conventional wisdom has long held that foreigners would continue to support the dollar. After all, what could replace it?

But that argument may no longer hold water.

China with its $1.6 trillion, and other countries with huge reserves, are looking elsewhere to invest. Many governments, especially in the Middle East, have created sovereign wealth funds not limited to U.S. investments.

They've been plowing their winnings into foreign telecommunications companies, airlines and financial companies. China and India are spending their increasingly valuable currency on importing food, energy and other resources,

But despite the gnashing of teeth by foreign central banks, there's scant evidence that they're abandoning the dollar even as it tests new lows. The International Monetary Fund's numbers show a slow shift from dollars into euros, with the dollar's share falling to 63% of all global reserves in 2007, from 65% in 2006.

That doesn't add up to a willy-nilly stampede out of dollars. Instead, look for a gradual decline in the dollar to continue as developing markets rake in more of the world's cash.

What to do now…

Hedge with real assets: The inflationary nature of *this* environment means you should look to own the stocks of companies that produce goods, not services. Companies that own gold, ferrous metals and iron mines, for instance.

Gold isn't reliant on a government promise to maintain the value of any currency. And while gold is up over 150% in the last 18 months alone, we think it still has room to run.

Martin Hutchinson, an analyst here at *Money Morning,* thinks you might want to consider **streetTRACKS Gold Trust** (GLD), an exchange traded fund (ETF). You might also look at Market **Vectors Gold Miners** (GDX), which tracks the major players in the field.

Go Global: The current meltdown in the U.S. credit markets couldn't have come at a worse time. Huge blowouts in dollar-denominated vehicles severely eroded the competitive edge U.S. dollar investments had over developing markets. That means foreign central banks will look to developing markets for the returns they used to get from U.S. assets.

Four places in particular stand to benefit. The **BRICs** (Brazil, Russia, India and China) all have burgeoning economies and significant natural resources.

Horacio Marquez, another of our analysts, likes **Petroleo Brasileiro SA** (PBR), Brazil's state-owned oil exploration company recently discovered the Tupi oil field, the second-largest discovery in 20 years. It also boasts top-notch management and leads the world in deep-water drilling technology.

If you're looking for more safety and diversification, **Rio Tinto PLC** (RTP) could fill the bill. It's the largest iron ore supplier in the world and just signed lucrative new contracts to feed China's voracious steel mills.

That gives you a starting place to look for relief from a weakening dollar. But the dollar probably won't implode in a sudden burst of volatility. There's simply too much riding on it for that to happen.

Here's the bottom line – the value of the dollar is largely determined by the confidence investors around the world foresee in the future success of the U.S. economy.

For right now that confidence is flagging and is likely to continue to slowly let the air out of the dollar in the future.

[Editor's Note: R. Shah Gilani – a retired hedge fund manager and a nationally known expert on the U.S. credit crisis – has predicted five key financial crisis "aftershocks" that he says will create substantial profit opportunities for investors who know just what these aftershocks are, and how to play them. In the Trigger Event Strategist, trigger events," as gateways to massive profits. To find out all about these five financial-crisis aftershocks, and about the trigger-event profit strategy they feed into, check out our latest report.]

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