Why Is Anyone Still Waiting To Sell The Dollar?

"The Fed can buy billions, even a trillion or so, but if and when the market is moving against the policymakers then there is no stopping. The Fed cannot stem that tide. There is only so much that they can manage and so it is something that they have to watch very carefully. At the same time, they are not terribly concerned. If the bond market is falling, you do not know whether it is because of more economic growth or because of more inflation, and you really only know after the fact.

So for now people think " We have economic growth kicking in", until the next economic numbers are not as great as expected and so it is a bit like a boiling frog syndrome. You print in all this money, you think everything is great and you have some warning signs but you think "Things are moving along" and by the time that you really see the damage you have created, it is quite late to undo this damage and it is going to be very, very expensive and painful."

So remarks Axel Merk, currency specialist and founder of the Merk Mutual Funds, who is perplexed by those waiting for additional warning signs to sell the dollar. In his view, we have all the evidence we need. He and Chris discuss the inner workings of the Fed and the course it is determinedly charting - and the looming dangers ahead for the US dollar.

Chris Martenson: Today we are speaking to Axel Merk, president, chief investment officer and founder of Merk Investments. Axel is a noted expert on world currencies and manages several mutual funds that manage currency risks for investors. For years he has been an outspoken critic of US monetary policy, warning investors that the current course risks seriously devaluating the dollar. The past few years have proven his warnings to be accurate. He is also the author of *Sustainable Wealth*, a very readable guide to understanding our macro economic environment, the risks today's investors face, and how they can mange their finances to achieve financial stability - very important in today's world. Axel, thanks so much for making the time to join us today.

Axel Merk: Hi, good to be with you Chris.

Chris Martenson: Let us jump right into, it, the US dollar is trading at its lowest level since the carnage in 2008 and there are many voices, yours and mine included warning it could go a lot lower. So if you could recap for our listener's right here and now how we got here and what is your outlook for the dollar?

Axel Merk: Well the dollar has really been on a very, very long term decline for decades and sometimes it puzzles me when people say "Oh, I will sell the dollar and get out of it if and when it does come down". I do not know what they are waiting for. And that trend has obviously had some ups and downs and has been accelerating in recent years. In recent times, we have had this major challenge that we are trying to grow at just about any cost, whereas our consumers they would like to really have a break. And it is not just now after the financial crisis, after the tech bubble burst after 9/11, we decided to keep America rolling and what happened was that we were just going out on an all-out spending spree in an effort to get this economy rolling. But when consumers in particular do not really like to spend, what happens is you are throwing a lot of good money after bad and that money really does not stick where it is supposed to be. Consumers like to downsize in the current environment, if they were left up to their own they would downsize in their homes, of course that means foreclosures and bankruptcies which our policymakers do not like so they throw a lot of money at the problem. Consumers do not want it and so the money goes where you have the greatest monetary sensitivity - that is gold, that is outside of the dollar into Australian dollar and other regions in the world, and we are just better at spending money than the rest of the world is and it is a trend that has been intensifying in recent years.

Chris Martenson: Well part of that trend is supported by being the world's reserve currency that is an exorbitant privilege, perhaps one that has been abused lately. So in my perspective every single recession we have had to this point, de-leveraging has been part of that process. This time it seems like the fiscal authorities in Washington DC and the monetary authorities at the Fed, they seem bent on making sure that we do not de-leverage this time, what is driving that?

Axel Merk: Well if we allowed market forces to play out, we would have the adjustment that from a purist point of view would be the appropriate thing: that the folks that made wrong decisions would need to declare bankruptcy. The problem is many, many people made wrong decisions. Millions of homeowners are underwater in their mortgage, we would have a depression and that is something that our policymakers do not want. And now we have Ben Bernanke who says he is a student of the great depression and he thinks he has all the recipes on how to not redo all the mistakes that we have. Think about the types of things Bernanke has said including testifying in congress: he has said going off the gold standard during the great depression helped the US recover faster from the great depression than other countries. Meaning if you debase your currency, you can get faster growth. If I take away half your money as far a purchasing power is concerned, you have a greater incentive to work. He has said a weakened dollar is historically not inflationary, we disagree but that is his viewpoint. On top of that, he is buying government bonds. So when you buy government bonds, those securities are intentionally over-priced signaling to investors they should rather go overseas where there are less manipulated returns. So both in word and in action he wants to debase the dollar as one method to spur economic growth and he needs that because we want to have consumers that spend, and consumers that are underwater in their mortgage are not going to spend. Now businesses have been much healthier, they have gotten on their feet doing the right things much faster. But consumers want to de-leverage and we do not want them to de-leverage because we have seen in any other country in the world that has had a hosing bust, we have economic stagnation for many many years. Now we have the same thing but we are trying not to have it and are throwing a lot of money at the problem except that all these theories that Bernanke has unfortunately do not work quite as well in practice. That is why we have inflation coming in, that is why we have the dollar weakening and the only response we get is 'we'll throw more money at the problem' because it just cannot be the way that the market wants it to be. It has to be the way the federal government wants it to be.

Chris Martenson: I have been concerned that yes you are exactly right that Bernanke had a theory, a thesis developed at Princeton. A lot of intellectual thought went into it; I am not sure how much real world applicable practice went into it given his career track. But let's assume he was right in his thesis, he had a good one. I am concerned that he is engaged in what I would call thesis drift where he came in and said "Listen, if we just throw a whole bunch of money at this, it will pick itself up and carry on" and that has not worked. So the response was "Well, let's do QE2" and even there we can say this is questionable in terms of its actual response to the overall economy and it seems like he is ready, wiling, and able to do *anything* necessary to prove his thesis right where it might not be correct. It might be that the conditions in the 30's were very different from the conditions today and all sorts of measures: being a net export nation, being a net creditor, being energy independent, etc and so forth. There are so many differences that it is almost impossible to catalog them all. Where do you think we are in terms of the Feds position right now? I know that you happen to have access to a former Fed official - if you can talk about that - and I am wondering if you have any insights for us as to what the Fed is up to and where they are going from here?

Axel Merk: The one thing I have learned over the years that our policymakers are quite predictable be that on the fiscal or on the monetary side and I do think that Bernanke is pretty much following his playbook. One of the things he has said is that one of the great mistakes during the great depression was to tighten too early, and as a result we deepened then the great depression or had the second leg downward and so he does not want to do that and he wants to err on the side of inflation. Right now, I have been arguing that the Fed can get away with murder. And what I mean by that is that because this money does not really stick anywhere. All this money printing – yes, it shows up in the excess reserves in the banking system but not all of it causes significant inflation. We see it in food and in energy but it takes a while for it to trickle through. The big concern I have is: let these policies work and we get substantial economic growth but what are we going to do then? If the Fed were indeed to mop all this liquidity, Bernanke has argued, he can raise interest rates in 15 minutes, where are we going to be then? The challenge is we have too much leverage in the economy, consumers are far more interest rate sensitive than they have been in the past and as a result we will plunge right back down. So in the best of cases we have a very volatile policy, and by the way before I talk about our own former Fed President who is our Senior Economic Advisor - contrast that with Europe where consumers stopped spending a decade ago. They were told a decade ago that there was not money for your pension; in the US they were told the same thing - except in the US they took out the credit card; in Europe, they stopped spending. And now the

Europeans can raise rates and they do not derail their economic recovery just because rates are a little bit higher. We simply cannot raise rates like Volcker did in the early 80's to contain inflation. If it needed to be, we would have a revolution if we were to raise rates to 20%, it simply does not work. Now you mentioned in house we do have Bill Poole as our Senior Economic Advisor. He is the former President of the St. Louis Federal Reserve. He is the one who voted against the emergency rate cut in January of 2008. He also was the one federal official who argued about bailing out Long Term Capital Management. He is now a senior fellow of the Cato Institute; he is very much a free market thinker. He is also a very pure monetary economist, he has obviously been around for some of the Greenspan policies but he has a very straightforward way of thinking and he makes for amazing discussions and in particular, what he is very valuable for us for, he helps us understand how the Federal Reserve is thinking, how the dynamics may play out. While he has an opinion on the dollar, he does not tell us what the dollar will do, but he helps us understand how central bankers are thinking. I think that is one way that we are a little different from other folks is while we criticize policies just as much as the others might do, we actually try to slip into their shoes sometimes and understand how they are thinking. Because ultimately it does not really matter what I think, it matters what the Fed thinks and what the Fed may do, and so as a result, I think it is very helpful to try to understand their thinking and how these dynamics may play out.

Chris Martenson: I completely agree you know, I have been saying repeatedly for a long time that investing is dead, we are all speculators and what we are speculating about it what is the fed going to do next. Since we have to guess at that, we do not really know - we do the best we can but so much seems to hinge on what they are going to do next and I have been following it just absolutely as close as I possibly can. But on pins and needles, ready to turn at a moments notice if it turns out the Fed surprises me in some way. You know, surprise used to be one of the tools in their toolkit; it has not been for a while. Right now, they have been saying we are going to keep rates low forever or indefinitely and we are going to funnel more money in at the drop of a hat if we see more weakness. Where do you see the Fed going next and what about this what appears to be at least in the public theater, a split in the ranks between sort of say what Bernanke is thinking on one side and what Fisher is saying on the other side if I can classify it that way?

Axel Merk: Sure, well a couple of things. First of all let's keep in mind what the Fed's role is and supposed to be. The Fed's role is supposed to be to take away the punchbowl when the party gets to be too hot. The Fed is not supposed to be the cheerleader to kind of push on the economy at any cost, and the Fed's role is to have a pursuit of price stability for the US under dual mandate also to pursue maximum sustainable growth. But we have kind of forgotten that especially because of the financial crisis that he Fed is always there to bail us out to help us - that is not their role. So keep that in mind first of all. Secondly, the Federal Reserve said that quantitative easing, the purchase of government bonds, is going to be finished this summer. Now some people say that that is an exit, by all means that is *not* an exit; that is a pause. The securities they purchased create money that is in the banking system. The banking system is awash in money ready to be deployed. So that is a pause and the most likely scenario is that they are just going to wait. There are huge, huge numbers of excess reserve that are just waiting to be used in order to give loans to the economy, and they can be employed at any minute, and so they do not need to do anything beyond that. The Federal Reserve is easing and is going to keep the economy awash in money whereas the rest of the world has been tightening. Now as far as the dissent is concerned at the Fed that has been growing, and of the voting members, Plosser is really the most vocal one right now but Plosser, Charles Plosser is by the way a dear friend of our own Bill Pool and I have met him and had discussions with him. He is a great man but he is not somebody to typically dissent in public. He is also somebody who likes to work behind the scenes and importantly, there is always this balance between the regional Fed presidents and then the governors, and the Fed presidents they tend to be academics. They have very strong views sometimes, sometimes they talk aloud, sometimes they are talk in quiet but often and typically, they are not the ones that are calling the ultimate shots. That is up to Bernanke, to the Chairman, Yellen who is the Vice Chairman, and the folks who are in New York who are governing. Now the Fed Presidents of course they can raise issues and possibly they can create dissent and that can create a debate. But ultimately if Bernanke has a strong will to pursue a policy, it will take a very great deal for those minority voices to be pushing Bernanke over.

I do not think that is likely to happen. What happened a few weeks ago is that we had a dozen of Fed speeches come out and first were all the Fed Presidents who were hawkish and then came the governors who said "No no, everything is fine, inflation is not a problem" and then people realized "Oh my god yeah, it is those governors who call the shots" - and that dissent is there, it is a concern, but ultimately Bernanke is gonna pursue his policies.

Chris Martenson: Well and he is just very recently on record as having come out at the end of all the noise that was coming out of the whole system and saying that maybe we would have "QE sort-of" is how I am terming it. Where they would continue to roll the maturing MBS paper into Treasuries on a go forward basis at seventeen billion a month or something like that. A far cry from the four and a half billion a day that has been pouring in under QE2 but still, money would be flowing in. So you are saying that is keeping ample liquidity in the system?

Axel Merk: Well there is going to be plenty of liquidity, and one thing to keep this in context is obviously there are different ways people look at inflation, they can talk about inflation is just the money that is being printed or you can talk about the money that is being used in the economy. But importantly, if you think about inflation - the two major schools of thoughts about what is driving inflation. What Bernanke thinks is that if we have a slack in the economy, if capacity utilization is not high, if unemployment is high, we cannot have inflation. And then there is the other school of thought that Plosser and us as well subscribe to that inflation is ultimately a function of inflation expectations. While that may sound like a circular argument, what that means is that if people believe that the Federal Reserve who is in charge of printing money can contain inflation, then inflation expectations will be contained. But if the trust erodes in the Fed then all bets are off. And in the 70's for example we saw that happening. That people thought oh my god inflation is coming in the system, we did have a slack in the economy, we did have unemployment high yet you could have inflation, push cost inflation. And we are entering exactly the same era where we have Bernanke who has explicitly stated last August in his Jackson Hole speech, he wants to have inflation move higher, and then he was upset that the market did not endorse him and he started QE2. He wants inflation expectations to move higher. He needs to have the price level more higher so that people are bailed out from their mortgages who are underwater. And in the early 80's when Volker said he was going to contain inflation, people did not take him seriously and it took a while. Well now, Bernanke says he wants high inflation; it is the same thing happening all over. The market did not take him seriously and by all means we will get higher inflation and at some point the markets will realize Bernanke was dead serious.

Chris Martenson: I am still not entirely clear what he is looking for when you said he wants higher inflation because is that inflation asset prices, I think so yes. Is that inflation in the traditional sense where all of the prices are moving up in a price wage spiral? I do not know if that is realistic at this point, because the wage component of that is broken, and has been for a while. And inflation is actually very very real depending on where you are on the socioeconomic spectrum. So for people under the median income it is very real what is happening to food and fuel right now. It is not transitory, it is actually quite punishing. So what do you think he means when he says he wants to see higher inflation? Is he really actually looking at the CPI or even their trimmed mean and thinking he is looking at a realistic measure of inflation?

Axel Merk: Well they are not looking at what we think is a realistic measure but what the Federal Reserve is looking at is they are looking at inflation expectations as they are priced into the market. Which is the spread between the inflation protected securities and the underlying Treasury securities. And there you can come up with a forward-looking inflation expectation, and what the federal reserve does typically, they say all right, the next two or three years or up to five years we can disregard because that might be temporary factors. So let's look at the market what the forward inflation expectations were based on the price in the market. Now of course some of these prices are distorted because the Federal Reserve has been buying just those securities. But there what you can see is that the inflation expectations were dipping just a little under 2% depending on which measure you are looking at going forward which is below the comfort level of most central banks, and since then have been moving steadily higher. But it is about 2% inflation that the Federal Reserve is looking for on that very crude measure that they are looking at and Ben Bernanke wants to have that move higher. Now in my view it has moved beyond even the comfort zone of a typical central banker. To your broader question of whether that is appropriate, of course we have seen inflation in food and energy go up and one of the things that people are not always aware of: that one third of the CPI is the rental equivalent, it's a value that you pay for pretty much your rental expense or your housing expense. Of course when you spend all your discretionary income on food and energy, you do not have much time to pay for rent. Now of course some people have moved to rental units and so forth, but still the upward pressure on rental prices is going to be very much held back if unemployment is high. It is going to be very much held back if people do not have any money to spend on rent and so by all means the measure of inflation that the Fed is looking at is going to be fairly well behaved. But in the meantime what we have is, we have had real wages not go anywhere for a decade. People are disenchanted, they are voting more from a populist politicians in the US from the Tea Party on the right to others on the left. What that means is that we are creating an environment where we are less and less likely to tackle the big issues & entitlement reform that we need to tackle down the road, and that is just in the US. In the rest of the world where we have exported our policies, we gets riots, revolutions and other things happening because the citizens are more disgruntled and you can oppress your people but if you do not feed them, they will start a revolution.

Chris Martenson: All right, so, I totally get that, and I am in complete agreement. Well said. So on the monetary side we have pressures on the dollar because we are holding rates between 0% and 0.25% where Europe has just raised rates, where Canada has higher rates where Japan has lower rates but they have their own issues going on. China is hiking rates. So there is monetary pressure as well, we are printing money like crazy still through QE2. On the fiscal side, what are your thoughts there? I do not want to get in to any sort of a political debate or discussion, when I look at the amount of money they are talking about cutting, $38 billion, it is a laughable amount compared to how much new debt is printed every week or the size of the deficit let alone the overall budget. We also seem to have fiscal pressures that are going to be pushing on the dollar. How do those play in particularly in this global economy now where it seems like there is no safe place to run?

Axel Merk: Sure, two answers to that, in the short term the absolute budget deficit has just about no correlation to the value of the exchange rates. We much more look at flow numbers that are the current account deficit that the financing requirement and so forth. But in the short term we see Japan has for example: a very high budget deficit, a huge amount of debt, those numbers are not very relevant in the short term. But what matters a great deal is the sustainability of the deficit, and in the US the math simply does not work. And if anybody who looks at those numbers knows we are heading towards a fiscal train wreck. Now politicians know that as well - some of them still think that you can tax the rich and be able to somehow solve these problems. It simply does not work with the math. And so what we have to do is we have to tackle entitlements. We have to tell people that they have to work longer and by the way when social security was first introduced, it was set at above the average life expectancy age, we have to have people have skin in the game in healthcare, Medicare, Medicaid. And they are both Republican and Democrat ways of tackling those issues. But we need to have a debate on that and luckily some of that is starting to happen. Unfortunately the proposal on the table by the Administration does not do that, the proposal on the table by the Republicans is too radical given the political realities. But at least we are starting a debate on that and S&P obviously has started in on it now by downgrading the outlook on US debt. With that hopefully we are pushing the debate more onto it. Now keep in mind no politician is going to change their mind on the budget simply because an analyst of S&P has decided to issue a warning. But it may put in motion a debate. Ultimately, look at Europe how this plays out in practice: the only language the politicians understand is that of the bond market and so we may have to wait until the bond market very clearly tells the politicians that they have to act. And we can act later on. I mean we can engage in reform now, the problem is it is far more painful the longer you wait and unfortunately it is quite likely to take quite a few years before we are going to engage in real reform. There is always the hope that we will do it earlier but as far as the dollar is concerned, it is that sustainability of the deficit that people are concerned about and we still have time, but the time is going to run out within a few years.

Chris Martenson: Interesting. You know, I do look at the Treasury international capital (TIC) report just to see if there is enough flowing in to cover that current account deficit on a monthly basis and it has more or less been - it is a little under but it is close enough. The interesting trend I have seen there is that foreigners are buying less and less and less on the long end, long-term securities, and more and more and more on the short end. Which to me is like if you are going to say eventually I am going to vote with inflation expectations or fiscal crisis expectations, what you are going to do is you are going to start voting by only holding shorter-term stuff first. You know, switching your preference on the maturities scale there. Have you been noticing anything like that or is that you know, an artifact or do you think that is a realistic observation?

Axel Merk: Well by all means and of course as interest rates go up or inflation expectations may go up, anybody who is investing in fixed incomes should consider reducing the overall duration of their fixed income portfolio. It is one of the things we do in our mutual funds, by investing in currencies that is really a special case of being at the extremely short end of the fixed income curve. We have never had a maturity of over 180 days for example in our currency fund. And so with such a tool you can reduce the duration of your overall fixed income portfolio. But what we have seen also on the government side: the US government has run its debt portfolio like an adjustable rate mortgage. Now luckily in the last 18 months or so the Treasury has tried to extend the maturity of that and at the same time of course as you point out, buyers of those securities be they domestic or foreign ones have been trying to reduce their maturity and that is a very healthy development. That is a debate that is happening, it is going to be reflected in the rates and so we have to see how that unfolds. But on the other hand of the spectrum of course, we have had many people chasing yields. The interest rates are so low and four-week Treasurers are yielding in the low single digit basis point. So 0.02 basis points and 0.02% you get for giving your money to Uncle Sam for a month. That is just about nothing. And so some investors have been going out on the yield curve have been buying longer dated securities in the hunt for yield and of course what happens then is you have money chasing those securities that has no business being there and the longer dated bonds can be very volatile in normal times. We do not have to be somebody who thinks of the crisis scenario to envision significant losses if the mood in the market swings, that is typical for the bond market. In recent years it has not happened as much but the bond market is a volatile place if you buy longer dated securities.

Chris Martenson: Interesting, it is certainly something I am following as closely as I can. One of the areas I do spend a lot of time in is commodities and I have been watching you know, this recent run in commodities. Honestly if you take a ten year chart out of the continuous commodity index, it has been phenomenal the run we have been on. It is 14% per annum for ten years annualized you know, there is a spike in 2008, a dip in 2009. But on average it is a pretty nice straight line except for this last recent blow off, if I can call it that that we are in the middle of. To me this feels like early inflation expectations playing out; it is risk assets coming forward. It feels like late 70's all over again, at least in terms of how commodities are behaving. Are there any parallels there? I mean how concerned do you think the Federal Reserve is about that, not even including the idea that you put forward which is the more we drive up commodities and export that sort of inflation through our policies the more the rest of the world, large portions of it anyway, are unhappy with the results that transpire in their homeland. How much do you think the Fed is paying attention to this? And I know they have come out and said it is "transitory"; I hate that word because Greenspan called oil prices transitory at $40 a barrel in 2006. Yeah it was transitory, and it transited right past $40 and never looked back. So where are they in this story right now?

Axel Merk: The parallels is see are in the tech bubble and the housing bubble. That for many years the markets move up and up and up and you have more and more folks come out and justified and argue that these prices can never come down. I think we have seen historic lows in the long-term mortgage rates probably last November or so and the Fed of course should be very concerned about it. The problem is they are running out of tools and the problem is also that the Federal Reserve can control short-term rates, but in the long end of the yield curve, there is very little they can do. The reason why the bond market is doing what the Fed wants them to do is because it continues to be confident in the Fed policies. But should the trust erode further in the Fed and it has been eroding over time a little bit.

The cheapest policy by the way is just a verbal announcement by a Fed president that he has to move to interest rate cuts, emergency rates cuts, buying of securities in the trillions and so if the policy, you can implement it, it is just getting more and more expensive. So when the markets do not listen to the Fed, the Fed is only one participant who is sipping from a straw in an ocean, and the reason is that the bond market, the fixed income market is just so huge and it really goes beyond the US market. You can buy other highly rated securities overseas and they are all very closely linked to US markets. So the Fed of course they can buy billions, even a trillion or so, but if and when the market is moving against the policymakers then there is no stopping. The Fed cannot stem that tide. There is only so much that they can manage and so it is something that they have to watch very carefully. At the same time, they are not terribly concerned, and the reason they are not terribly concerned is because they only have that one level. If the bond market is falling, you do not know whether it is because of more economic growth or because of more inflation, and yes you can look at the inflation protected securities but you really only know after the fact. So for now people think "Oh yeah, we have this economic growth kicking in", until the next economic numbers coming in are not as great as expected and so it is a bit like a boiling frog syndrome. You print in all this money, you think everything is great and you have some warning signs but you think "Oh yeah, things are moving along" and by the time that you really see the damage you have created, it is quite late to undo this damage and it is going to be very, very expensive and painful.

Chris Martenson: Well let's talk about what I consider to be the key commodity when it comes to these sorts of expectations and one that I know the Fed tracks very closely or has historically, I assume they still do. Precious metals, gold particularly, on a huge tear of late I would say, I think we are over $1,505 right now unless it has done something crazy since we started talking and silver just popped over $45 I believe, and so a huge run following a decade of year on year gains. So what are you views on the precious metals? Do you believe in them as an investment at this point and what is the outlook?

Axel Merk: Well, first of all I am not so sure how much the Fed really looks at gold. I think everybody has their personal view on the Fed. They are not very happy about gold being that high, but ultimately I do not think that is the main thing that they look at. It is something they do look at but not as a main driver. Now as far as we are concerned, gold is the ultimate currency because it is not so easy to print, it is very difficult to ramp up production of gold. Having said that, it is the one if you call it currency that is more volatile than other currencies because the market is just much much smaller. If you look at China, they are trying to increase their gold reserves but they are trying to be pretty well behaved participants in the markets. So as a percentage of their total reserves, gold has been going down and because they simply cannot buy enough gold to keep it up. As far as our firm is concerned, we have gold as a core component in our main strategy and as far as I am personally concerned and even before that, I started to accumulate gold. Gold I believe will do well as long as we do not change policies in the US that move over to fostering savings and investment because until then we will continue to be vulnerable in the dollar as long as we continue to fight rather than embrace market forces. And if you look at it, and you mentioned earlier Europe is raising rates. Yes sure, we have rates at 1.25% in the euro zone right now, but inflation is running at 2.0%, so we still have negative real rates even in the Euro Zone. So even though I like the way they pursue the policies and we can talk about that, it is still something where we are very accommodating. Also, keep in mind we have a global debt to GDP ratio in developed countries, in the OECD countries that is over 100%. We have never had that before in peacetime, we have some minor wars going on but in general, in peacetime we have never had that happen. Inflation almost certainly is going to be part of that solution and that is an environment that will continue to foster gold, and because the gold market is so small, that is why you can see these extreme moves that can go far beyond where we are right now. It was very difficult as we saw in the early 80's this major, major blowout, we have not see the panic buying and as long as we still have so many skeptics out there in gold, we like gold. Having said that be aware that gold is quite volatile and there can always be a sharp correction. One of the reasons why we prefer gold over other commodities is because one the one hand the simplicity of gold because it only or primarily has the monetary sensitivity and not so much industrial use; and secondly because it is far less volatile. Silver can move 10% in an hour, by all means we like silver but you have got to have a good stomach in order to stomach the volatility that comes with silver.

Chris Martenson: Oh absolutely yeah, silver has got an industrial story to me and one that I really actually like on a long-term fundamental basis. I do not think it has a monetary role simply because there is actually not quite enough of it on the surface of the planet compared to gold, and gold you already mentioned is a small market. Silver is tiny compared to gold so not very favorable on that run. I am not a gold bug I am an anti dollar bug as it were. Gold for me is a way of side stepping mismanaged currency. On a fiscal basis and a monetary basis I have strong disagreements of what we are doing right now, it does not look sound. But you hit on the key thing for me which is as long as rates are negative, I am very much gold bullish and I know that the official story is CPI trimming, CPI Core or whatever. But my personal CPI rating that I hand-assemble is much higher than the official ones, it is a couple points higher and so I would need personally to see short-term rates in the vicinity of 5-5.5% before I would start to feel like they were neutral to positive. I know other people have disagreements and have different numbers but that just to put it in context, I would need to see 500 basis points of interest hikes before I start to become really fundamentally concerned at this point about one of the key supports for gold price.

Axel Merk: Well just as a comment there, think about what would happen if we were to raise rates to 4-5% and indeed countries like Portugal, they scream for help from the European union because their cost of borrowing was going to something like 5% and it has gone beyond that since. But still 5% is not that high, at the same time if you look at the municipal bond market in the US, some people are saying well, the interest service payment for the municipalities is not all that high. Well yes, because they are paying only 1-2% on the interest. Let that go up, let the Fed tighten and suddenly let that debt servicing double for those municipalities and then we are going to have very serious problems. But one of the challenges of having low interest rates for an extended period is that you encourage everybody to take debt, and not just consumers but also government and municipalities. So what happens is we have a far greater interest rate sensitivity and that means we are far less shock-resistant be that on the consumer side if you lose a job or be that on, just on the government side. And all the budget projects by the way, by the CBO are based on the current interest rate environment and it is just unrealistic to think that that is going to continue forever. At least there is substantial risk in that. And the key difference here between the US and the euro zone for example is in the US we have a current account deficit. As you pointed out earlier we are dependent on foreigners to finance that; in Europe you do not have that and so in the US and the countries with a current account deficit you need to have economic growth in order to attract money, in order to have the currency be strong. In the euro zone you do not need to have that, you see that very clearly illuminated in Japan where the worse the economic performance is the stronger the yen seems to be and that is because they finance the deficit domestically. When their economy slows down be that because of an earthquake, be that because they had six Prime Ministers in six years, as a result consumers are saving more and six Prime Ministers in six years means that they are not effective in spending programs and exerting pressures on the Bank of Japan. So only when they get their act together is the yen going to tank, and so the dynamics work a little bit differently in different countries. But in the US we need that economic growth and by all means if we are going to get interest rates to 4% or 5%, that would push us right back into a very severe recession, probably depression.

Chris Martenson: I agree with that, it really feels like a rock in a hard place, it is a classic bind. It feels like in trying to avoid the liquidity trap we have gotten ourselves into a much worse trap of a form and I do not quite see how we get out of this. So my question for you is how does the average investor preserve wealth during this period of time? It seems just horribly complicated, we have to guess a lot and normal correlations, and risk patterns are changing constantly. How do you help people navigate this mess if I can call it that?

Axel Merk: Well a couple of things that we would like to point out. One is that we have argued for a long time that there is no such thing anymore as a safe asset and investors may want to take a diversified approach with something as mundane as cash. You may want to consider hedging your dollar risk be that in your cash side, be that on your equity portfolio, and obviously there are many ways of trying to do that. Basically you have to look at asset location without the risk free alternative, everything is risky these days. Now on top of that and you talked about correlations, one of the side affects of having so much involvement by policymakers is that it feels great when another trillion is spent. The problem is that all asset classes are moving in tandem. So where do you hide when things turn bad? It is great on a day when the market goes up by 200 points. But where do you go when the market goes down? And that is why we have veered over to the currency space because in the currency space you can design a portfolio where you can have low correlation in your portfolio versus anything else that you are holding. Also you can directly play on the policies. Why do you hold Cisco, and I am not trying to have an argument for or against Cisco but why do you hold a Cisco you have the corporate risk when ultimately the only reason you buy Cisco is because you believe in economic recovery. Well do it on a currency side where you strip out the corporate risk and you can take a position based on the mania of our central bank as in our policymakers. So more and more investors are embracing that and it is, people always say oh my god, currencies are so complicated, but in the end no, they are much easier because our policy makers are highly predictable and you only have about ten major currencies to worry about rather than thousands of stocks. Some people say currency is zero-sum gain; well no it is not, we are better at printing money than other countries are. So that has very direct implications to the value of the currency relative to one another.

Chris Martenson: Excellent - because you know, if there is one thing I am extremely bullish on it is the mania of our policy makers. I absolutely agree with that as an outlook and it is something I have been arguing for a long time. When we look through history and we see very clearly that when presented with the options of either deflating or inflating, inflating is always chosen if ever possible. So no reason to suspect this time will be different. So I am very interested in this idea of how you get people exposed to other currencies because one of the things I tell people to do a lot is to diversify away from the dollar, and depending on how much wealth you have got, it requires either a little or a lot of effort. I am interested in the ways that you can help people who want to do that. So how can people find out more about your work, what your investment opportunities are and importantly to follow what you are thinking?

Axel Merk: Sure, we have three mutual funds, the Merk Funds, the Merk Mutual Funds and the best way to learn about them and get a prospectus and all that is at merkfunds.com, M-E-R-K-F-U-N-D-S.COM. I like to stress we typically do not use leverage, we consider ourselves currency investors and not speculators. Sometimes currencies have reputations of being highly speculative but you do not need to be leveraged by a speculator in order to make money in currencies. We have a hard currency fund, an Asian currency fund, and absolute return currency fund. The titles are pretty much self-explanatory but look at our website to learn more about them. We have a newsletter there, a free newsletter there where we talk a lot about these dynamics and the currency markets as they unfold building on what we just discussed here. I encourage anybody to sign up there, go to our website, learn more about them, and then shoot us an email through the website if you have any questions.

Chris Martenson: Great fantastic. You know, actually I hope we get to meet again when I come out your way. I know we had an opportunity to meet last time I was out and really enjoyed that. So I want to thank you for an illuminating discussion today, just fantastic.

Axel Merk: My pleasure anytime.

Chris Martenson: And you know what, I hope you and I are wrong about the dollar but hope alone is a terrible strategy. So let's plan and act as if we are not.

Axel Merk: By the way, just on that point we fully agree, we do not have a crystal ball. The question is not whether we are right or we are wrong, the question is, is there risk that we are right and if so, should investors take that into account in their portfolio location? I wish to be wrong as well, and we do everything we can to encourage policy makers to do the right move, but unfortunately I think there is a risk that we may be right and if so, you may want to take into account in your location if you, as you allocate your portfolio.

Chris Martenson: Perfectly well said, I could not agree more and that is how I have been allocating things for quite a while in my own life. So I am hoping for the best but planning as if maybe that is not going to come about and structured my portfolio accordingly. So again hey, thanks again, I really appreciate it.

Axel Merk: Yeah, take care.

Chris Martenson: All right, bye bye.