Daily Dispatch: Too Big To Bolt - Nov 16, 2009

By Casey Research
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CASEY'S Daily Dispatch
November 16, 2009 | www.CaseyResearch.com

Too Big to Bolt

Dear Reader,

Briefly continuing the story from last week in which I set out one fine morning to "terminate with extreme prejudice" a fisher cat, I received a letter from Alan, a dear reader who has, among other entries in his resume, acted as a professional wolf hunter.
In his letter Alan broached no argument with my decision to send the cat- and dog-killing weasel to whatever passes as Valhalla for woodlands creatures. But he did wag a verbal finger at me for not sticking my nose far enough into the fisher cat's dark hidey hole to verify it wasn't wounded and suffering.

Having hunted a fair bit as a youth on the Big Island of Hawaii, I could not dispute the correctness of Alan's position. While the fisher cat and I may have our disagreements, nothing in its nature should condemn it to prolonged distress.

And so, outfitting myself for close-up work, which is to say with a stick and a sharp knife – and with a word over the shoulder to the kids to be standing by the phone should the worst come to pass and I'd need medical attention – I headed down to the fisher's lair under the large boulder at the bottom of the yard.

Pushing the old saw "No good deed goes unpunished" out of my thoughts, I got down on my hands and knees and peered deep into the dark recesses of the hole. Nothing. So I got lower and pushed my face in further. There! In the farthest recess of the hole I could see it.

No, dear reader, not the dreaded fisher – but a glimmer of light from the back of the lair. Walking around, I confirmed the fact of the matter: the fisher had, intelligently, left itself a way out – and had apparently used it to beat a hasty retreat when I showed up at his front door with my shotgun a few days earlier.

And so, Frodo the Fisher, as I have come to think of him, lives to see another day. However, as the name of these daily musings is not Casey's Daily Hunt, I'll adroitly move on to an animal of another sort, a beast far larger and more dangerous than even the most foul-tempered fisher.

I refer to the living, breathing organism of government. I can and will stretch the metaphor to point out that like Frodo the Fisher, the government has run itself into a hole. And, like Frodo, it has allowed itself an escape hole – the ability to print money from thin air.

Too Big to Bolt

So far, the government's reliance on the escape hole of the printing press has come in very handy… during times of war, recessions, and dot.com stock market crashes. So accustomed has it become to using this particular avenue that it's become habitual. Consequently, when faced with danger, no hesitation or further reflection is required before quickly scampering to the printing presses.

While history still contains many mysteries, there's nothing mysterious about the long list of bitter disappointments suffered by those who learn, too late, that something has unexpectedly changed that disrupts the best-laid plans.

In the current case, the thing that has changed is that the government may have grown too big to fit through the hole to salvation.

The two charts below help make the point.

The first, from data provided by the Cato Institute, provides a historical perspective on the steady increase in the size of the government. As you can see, with the single exception of the pedal-to-the-metal spending increases of WWII, the size of the government's role in the economy is now ticking along at unprecedented levels.

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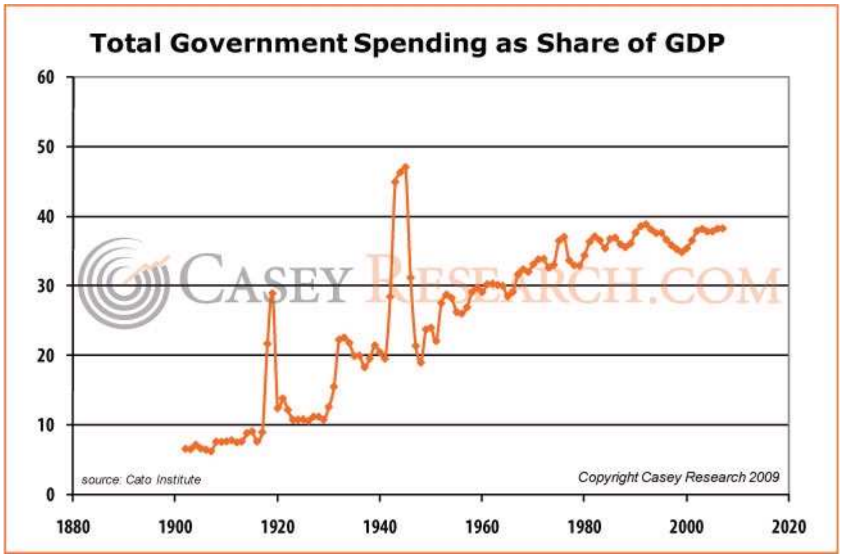

It’s worse than that, because the picture doesn’t include the extreme deficits the government is planning on running in the years just ahead, nor the massive spending associated with the passage of universal healthcare.

Reflecting on this takeover of the economy is reflecting on the winners and losers inherent in the evolving situation; as the government doesn’t actually produce anything, its gain in economic share must come at a cost to the private sector.
Fully exploring this line of query requires more time and space than I have here, but I’d like to briefly comment on an important aspect to this takeover.

Specifically, the government has become the largest single component in the economy it is supposed to be shepherding. That has consequences I will try to unveil --- so please bear with me for a minute.

Visualize what would happen if the government was to wake up one morning and decide that the greedy bankers needed to be put in their place. Were that to be the case, it could cut the bankers down to size by dashing off some new regulations and/or levying new taxes and fees on the miscreants.

Likewise, if the government decided that excessive speculation were driving energy prices to artificial highs, it could follow much the same route. Repeating this exercise over and over, punishing that group and rewarding this group, is much how the government operates.

But what happens, I ask, when the biggest component of the economy, and the biggest problem it confronts, is government itself?

After all, a government can't tax itself (well, it could, but what would be the point?). And while it should regulate itself, few instances of it doing so effectively pop to mind. Thus, we are left with a situation where the sheer size of government limits its options.
In the current context, it’s no secret that Jabba the Fed is sharpening its claws with new taxes aimed at high-income earners, but then what?

Half of the nation pay no taxes at all, so they're off limits. And even the middle class, which is said to make up about 60% of the population, won't provide much fodder for the federal gut. According to the Census Bureau, you’re considered middle class if you earn between $19,000 and $92,000 a year. Of course that's a fairly wide range, and those at the bottom of the range certainly aren’t rolling in the stuff. Even those at the top of the range, having roughly half of their income deleted by taxes of all description, don’t have much of a cushion with which to soften life’s harsher blows – let alone save for a comfortable retirement. And they sure won’t react well to having to carve a larger slice of their small pie out for more

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taxes. Ergo, Obama's pledge of no middle-class tax increases.
The point I'm trying to make is that the remaining tax-paying sheep have only so much wool to shear. And when they're trimmed down nice and tight and the government is suffering the ultimate fate of all socialist regimes – namely, it has run out of other people's money – then where will it come up with the sustenance to support its inflated self?

Per my lead-in, history does provide an answer to that -- and that is to ramp up the money printing. But that runs into the reality that the government of these United States is now so bloated that it's dangerously close, and maybe even past the point, to being unable to use this familiar way out.

The next chart from our own Bud Conrad points to the risks inherent in the unfettered deficit spending required to maintain Jabba the Fed, once it has sucked all the life blood it can from the thinning ranks of taxpayers.

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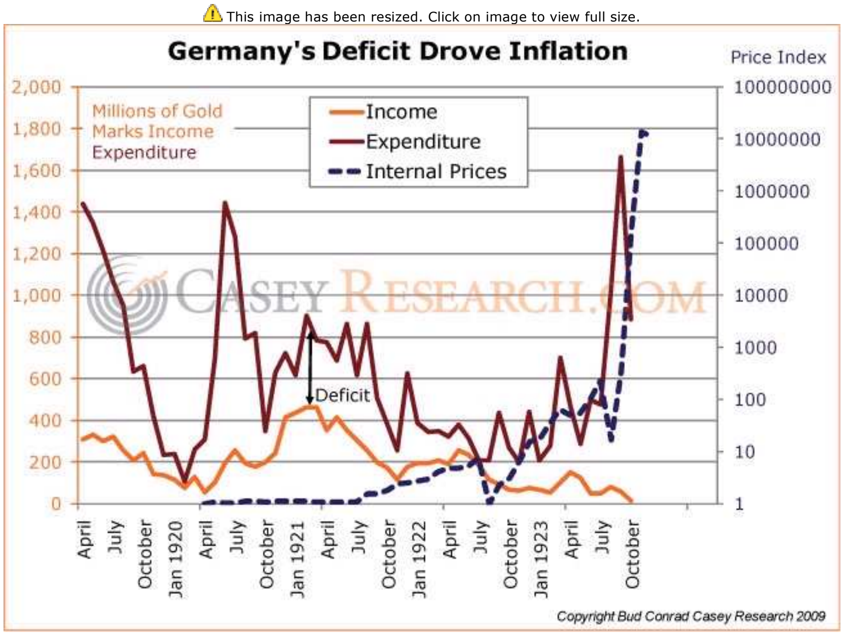

Simply, we are reaching the point of no return. The point where the government's tried and true method of pushing problems down the road through printing unbacked dollars may well be reaching its limits. And in fact, it may have reached its limits – which is why we've seen so little in the way of dollar rallies of late.

That's not to say they won't occur, but looking at the golden barometer this morning, I see that gold has just broken through to a new level of $1,132 per ounce. And the dollar index (DXY:IND) has just broken through the 75 long-term resistance point… to 74.91 as I write.

Bud Conrad, who lives and breathes this stuff – almost literally – now thinks the conditions are there for an actual dollar collapse. While it's unlikely things will reach the depths pictured in the chart of the German hyperinflation just above, it doesn't mean it can't happen.

What can't happen is for the U.S. government to take over the economy and expect it to keep ticking along through a combination of higher taxes and debt monetization.
[**Ed note:** Investors will need all the help they can get to protect their assets and prosper in the challenging years just ahead. ***The Casey Report***, with comprehensive monthly analysis on the powerful trends that count – as well as the best ways to invest – can help. Give it a three-month, risk-free trial today. You literally have nothing to lose. Clicking here gives you the information you need to know.]

Moving on, the following reminiscences were written by our own Shannara Johnson, an editor and researcher here at Casey Research. Shannara was born in West Germany and was living there at the time of the fall of the Berlin Wall, the anniversary of which was celebrated last week.

The lessons evident in her essay are relevant to the situation in the U.S. today, where the government's blossoming role in the economy has created a large population of citizens who are net recipients of government largess.
Here's Shannara's article…

Eyewitness to History: The Wall
By Shannara Johnson

My mother-in-law asked me yesterday what it was like for me when the Berlin Wall came

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down twenty years ago, and as a reply I sent her this little write-up.

I was 24 when the Berlin Wall fell, but back then I wasn't very interested in politics. Of course I saw and heard some of it, but I wasn't exactly glued to the TV. One thing that I remember when the Wall started to come down were the images of West Berlin residents throwing bananas to the East Berlin residents, who eagerly caught them… like monkeys in a zoo. (They didn't have exotic fruit in East Germany back then.) I was appalled, it was so degrading.

At the beginning, right after the fall of the Wall, the atmosphere in Germany was very celebratory; it was genuine happiness by all that the imprisonment of our "brothers" in East Germany had ended. But pretty soon after, the first critical voices appeared. From a West German's perspective, our government was doing everything it could to make the East Germans happy, subsidizing them so they could adjust to their new lives… but they weren't as grateful as we thought they should be.

For a while before the fall of the Wall, they had been receiving West German TV – and they took all they saw at face value, including soap operas and commercials. Many of them thought that every single West German was living in luxury, was driving a Mercedes, owned a four-bedroom house, had unlimited credit and a stereo and TV in every room. What they didn't realize was, a) not everyone had these things, in fact, very few people did; and b) that the people who *did* have these things had worked hard to get them.
How do you get nice things without having to pay for them? Credit, of course. Credit card companies were extending offers to the East Germans, and they took them all. Within a few months, many of them had gotten themselves into credit card debt up to their eyeballs – with no hope of ever paying it back.

The East Germans had no concept of capitalism, competition in the marketplace, and working hard to achieve things. In communist East Germany, someone would, say, work at the equivalent of a grocery store, and one week they'd have potatoes and carrots, the next week they'd have spinach and radishes. There'd be long lines of customers at the store to get the food, and when the inventory was gone, it was gone, and the store clerk would close up shop and go home. Aside from having no incentive to work harder – for what, if you can't get promoted or make more money? – there was of course the "power of the little tyrant" coming into play, e.g., that little store clerk had the power to decide who would get groceries and who wouldn't. If you had a "good connection" (which probably involved bribery) with him, great. If you ticked him off, tough luck. Something like "customer service" was unheard of.

Needless to say, the East Germans were not equipped at all to deal with a capitalist society. They felt they were *entitled* to the lifestyle the "rich Westerners" had, but the government subsidies they received after the Wall came down weren't enough to allow them all those things without working. Or, for that matter, even if they did work – because they were, of course, less savvy than their West German counterparts and so had trouble finding (and keeping!) a job. And those who stayed in East Germany found that the same jobs didn't pay as well in the East than they did in the West.

The West Germans, in turn, got more and more angry at the "lazy bastards" who thought they could get something (or more like *everything*) for nothing. A friend of mine who had escaped from East to West Germany with her mother as a small child, and now got to see her East German relatives more often, complained they were excruciatingly greedy and envious. She told me they would visit her modest house and look at everything she had, making nasty comments like, "How nice that *you* can afford something like that."
So, to make a long story short, after less than a year, I heard many people only half-jokingly say, "Let's rebuild the Wall."

As far as I know, these differences, even if they have subsided somewhat, are still in place. Even worse, disillusioned and disappointed with the "capitalists," many East Germans started listening to demagogues who would tell them what they wanted to hear – that they had a *right* to get better jobs and more money, and that it was the damn foreigners stealing it from them. So it's probably no surprise that East Germany has a disproportionate number of Neo-Nazis… a swing of the pendulum from one extreme to the other.

Eyewitness to History – Part Two

In the mail bag last week was the following from Frank G. on the topic of Afghanistan that I thought interesting, in the context of my essay on that country last week.

> I agree with your view on Afghanistan. Interestingly, on Veteran's Day I was standing in line waiting for a sandwich and I happened to overhear the young man next to me say he was going to Applebee's for dinner because on Veteran's Day, "Vets eat for free."
>
> I asked him if he was a vet (he looked awfully young to me), and he said yes. I thanked him for his service and asked if he had been to Iraq. He said, "No, I just got back from Afghanistan." I replied, "Really, what do you think we should be doing there?" He looked directly at me and stated clearly, "Getting out."
> I asked why he felt that way, and he said that no one there, including those on the front lines, really knows why we're there or what we're trying to achieve. He said if it's "nation-building" we're there for, the Afghans "don't want our help."

Just thought I'd pass along this first-hand opinion.

All in all, the mail on my article last week arguing against throwing more troops into Afghanistan have been very supportive, so thanks. At this point, I can't think of another issue that will weigh more heavily on my opinion of President Obama than what he decides to do with Afghanistan. If he makes a political compromise that sinks the nation even deeper into that morass, then I'll lose all hope – versus only most.

And with that, dear readers, I will sign off for the day. As I do, I see a lot of green on the screen for stocks in general, and gold stocks in particular. One such stock, Canplats, a long-term holding in the portfolio of the ***International Speculator***, is up 37% on the day, thanks to a buy-out offer from large cap producer, Goldcorp. This is the sort of activity we'll expect to see a lot more of as the bull market in precious metals continues.
(Nobody does a better job on junior gold stocks – a house specialty, if you will. Learn more about a no-risk three-month trial to ***Casey's International Speculator here***.)

Gold, meanwhile, is at $1,132 as I sign off. With the dollar edging closer to a free fall, it's getting increasingly difficult to see what could cause gold to fall back below $1,000. We've been on the right side of the trends of the past decade that have left gold, our top investment pick throughout, in quadruple digits. It has made a lot of dear readers a lot of money… but I suspect we haven't seen anything yet.

That said, do keep some sense of proportion – almost every portfolio benefits from diversification. At this point, our general allocation is one-third precious metals-related investments, one-third cash (keeping powder dry for the values we think we'll see during the next leg correction), and one-third "other."

In my own case, much of the other is in foreign real estate, as that offers a combination of lifestyle, political diversification, and upside from being early in an up-and-coming area. And that's it for today. Until tomorrow, thanks for reading and for being a subscriber to a Casey Research service.

David Galland
Managing Director
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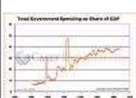

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