

In This Issue:

Investment Insights from Louis Boulanger: *Prosper!*

[We Have It Coming](#)  
[Near a New Tipping Point of the Crisis](#)  
[Residential Property: A Bottomless Pit?](#)  
[Is There a US Dollar “Rebound”?](#)  
[Is This the End of a Fiat Currency Bubble?](#)

[Web Version](#) | [Send Message to a Friend](#) | [Update Your Profile](#) | [Unsubscribe](#) | [Ensure Delivery](#)  
| [Feedback](#)

[View Online](#)

Issue 22 - 23 May 2008



The header features a dark background with the word "Prosper!" in large white letters. Below it, the text "Dear Prudence, Won't You Open Up Your Eyes..." and "Investment Insights from Louis Boulanger" is visible. On the left is a portrait of Louis Boulanger. To his right, his name "Louis Boulanger CFA" is listed along with his office and mobile phone numbers. Further right is the logo for "louisboulanger now" with the tagline "Freethinking Investment Strategies".

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[We Have It Coming](#)  
[Near a New Tipping Point of the Crisis](#)



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#### We Have It Coming

*“Those entrapped by the herd instinct are drowned in the deluges of history. But there are always the few who observe, reason, and take precautions, and thus escape the flood. For these few, gold has been the asset of last resort.”*

- Anthony C. Sutton  
(1925 – 2002)

*British-born economist, historian, and writer; Sutton published many books; several have become classics in the study of covert politics and economics in the twentieth century.*

Over the last few weeks, a number of significant participants in the financial markets have increasingly come out of the closet and made some very strong remarks, most of which have been either dismissed or ignored by the mainstream press and so, 'the people' remain deluded, misinformed and comfortably numb. Here are just a few noteworthy quotes that I thought you may be interested in, assuming that you are unlikely to have already read or heard this on 'the news'...

### **Horst Köhler**

The current German President Horst Köhler called the global financial markets a "monster" and accused officials in the banking industry of not sufficiently apologizing for their shortcomings. He said, on 14 May:

*"By now it must be clear to every responsibly thinking person in the industry that the international financial markets have become a monster that has to be shoved back into the cupboard."*

- Horst Köhler  
(1943 - )

*He is also the former Managing Director of the International Monetary Fund (IMF). See the full text [here](#).*

### **Paul Volcker**

Former Federal Reserve Chairman Paul Volcker (he preceded Alan Greenspan and was Fed Chairman from 1979 to 1987) said in testimony to the congressional Joint Economic Committee in Washington that he was increasingly concerned about the Fed's interventions in the securities markets. He said, on 14 May:



*"If we lose confidence in the ability and the willingness of the Federal Reserve to deal with inflationary pressures and buttress the dollar, we will be in real trouble. That has to be very much in the forefront of our thinking. If we lose that we are back in the 1970s or worse."*

- Paul Volcker  
(1927 - )

He is widely credited with ending the US' stagflation crisis of the 1970s.  
See the full text [here](#).

### **George Soros**

George Soros has written another book, entitled "The New Paradigm for Financial Markets: The Credit Crash of 2008 and What It Means". In comments that will heighten families' fears about their finances, George Soros said the worst of the credit crisis could be yet to come, with the world economy enduring a series of major aftershocks. "We are in the midst of the worst financial crisis since the 1930s," he said in an interview on National Public Radio (in the US) on 12 May:

*"In some ways, [this crisis] resembles other crises that have occurred in the last 25 years, but there is a profound difference: the current crisis marks the end of an era of credit expansion based on the dollar as the international reserve currency. The periodic crises were part of a larger boom-bust process; the current crisis is the culmination of a super-boom that has lasted for more than 25 years.*

*"To understand what is going on we need a new paradigm. The currently prevailing paradigm, namely that financial markets tend toward equilibrium, is both false and misleading; our current troubles can be largely attributed to the fact that the international financial system has been developed on the basis of that paradigm."*

- George Soros  
(1930 - )

*Hungarian-born American financial speculator, stock investor, philanthropist, and political activist; he is famously known for "breaking the Bank of England" on Black Wednesday in 1992.  
You can find the interview [here](#).*

### **Gore Vidal**

Amy Goodman of 'Democracy Now!' interviewed legendary author Gore Vidal earlier this month on the Bush Presidency, history and the "United States of Amnesia". It is a priceless and riveting interview of a giant who speaks casually and frankly as if he has (or is close to having) lost all hope on the idea of what America was meant to be. She asked him for his thoughts on this election year and on the last eight years of George W. Bush in the White House:

*"Well, it isn't over yet. You know, he could still blow up the world. There's every indication that he's still thinking about attacking Iran: 'And the generals are now reporting that Iran is a great danger and their weapons are being used to kill Americans'. I mean, you know, I think, quite rightly, the Bushites think that the American people are idiots. They don't get the point to anything. There are two good reasons for this: the public educational system is one of the worst in the first world and they end by knowing no history, certainly no American history."*

- Gore Vidal  
(1925 - )

*American author (e.g. Perpetual War for Perpetual Peace or How We Came To Be So Hated); he is an outspoken critic of the American political establishment and a noted wit and social critic.*

Interview [here](#)..

### Meanwhile...

Back in the White House, George 'Dubya' Bush says he gave up golf in order to "show his solidarity with the mothers who lost their sons in Iraq"... What?! Yep. You've read correctly. From one of the most absurd interview segment I've seen so far with the current US President, comes a brilliant retort or a healthy reaction from Keith Olbermann in the form of a Special Comment that I encourage you to see and listen to. You can find it [here](#).

Well, as it turns out, that too (Bush claiming he gave up golf) was a lie, as Olbermann shows. So many lies, so little truth... Where, oh where, will this Orwellian nightmare take what's left of America (and the rest of the world) ultimately?!

**Please note that all past issues of *Prosper!* are available [Here](#) for your convenience.**

[Page top](#)

### Near a New Tipping Point of the Crisis

*"Political language is designed to make lies sound truthful and murder respectable and to give the appearance of solidity to pure wind."*

- Eric Arthur Blair  
(1903 – 1950)

English writer, journalist and novelist, better known by his pen name George Orwell.

Despite all the signs indicating that the crisis is actually going on (i.e. more bank losses and continued process of financial asset depreciation, increasing weakness of large insurance companies, steady collapse of housing prices, contamination to the real economy, etc...), financial authorities, large banks and the international mainstream media have undertaken to pretend that the crisis is, if not over, under control... Ha! Plus ça change, plus c'est pareil.

Attentive readers will recall that this time last year, the authorities and large financial institutions attempted to conceal what they probably knew was already happening and is now of course widely recognised and reported as the subprime crisis (and other names, as the so called crisis evolves). The effect was of course not to remedy the situation but simply to defer the inevitable.

In the eight months between September 2007 and April 2008, the US central bank (the Fed) cut interest rates seven times from 5.25 percent to 2.00 percent. On top of that, they have rolled out huge and ongoing injections of "liquidity" into the system. They have opened new borrowing channels untapped since the 1930s. And they have turned themselves into the repository of last resort for the debt paper which neither they nor the commercial banking system dares

expose to market valuation.

The Fed is accepting any type of debt paper in exchange of Treasury debt. So is the Bank of England. And more recently (and closer to home), the Reserve Bank of Australia has also started to do so recently and two weeks ago the Reserve Bank of New Zealand announced that they are prepared to do the same. Fantastic! All for one and one for all!!

In short, the central banks have done everything they can do to restart the credit expansion on which their global banking system depends. That being the case, officials have no choice but to insist that their efforts are “working”... which explains the litany that the credit crisis is nearer to its end than to its beginning.

Well, in the coming weeks I expect that we will experience a “remake” of the same scenario as last year, i.e. what appeared to be a serious increase in systemic risk during the first ten weeks or so of this year (and was temporarily stopped by the Fed funded bailout of Bear Stearns by J P Morgan), will eventually re-emerge and morph into a full blown financial crisis – probably at some stage later this year or next year – as happened with the crisis last year. Will you be prepared?

### **Residential Property: A Bottomless Pit?**

Home prices have initiated a freefall in a growing number of countries. In the aftermath of the US, it is now the turn of the United Kingdom and Spain to plunge into the housing crisis, while in many more countries, including Australia and New Zealand, it seems a major slump has now begun.

Indeed, under the threefold effect of a credit crunch (or squeeze, if you prefer), a burst housing bubble and an economic recession (yes, pretty much everyone now agrees that the US is in a recession, except of course the official statistics), house prices are dropping fast in the US – see the chart below.



Source: Standard & Poor's and Fannie  
S&P/Case-Shiller Home Price Indices – April 2008 – Source: S&P  
Legend: Full line: 10 largest US city index / Dashed line: 20 largest US city index

There are growing signs that this is now extending to commercial property and not just in the US. Gee, I wonder if that will include today's developers'

“paradise” of the petro-monarchies in the Persian Gulf...

The global systemic crisis still has long to live, having nothing to do with this virtual reality where central bankers, private bankers and financial media seem to be operating. Hummm... Something tells me that large financial institutions are taking advantage of this window of opportunity or fabricated euphoria and managing to shed or share large parcels of past and future (even greater) losses by launching vast operations of recapitalisation or making the most of what they can swap with central banks using other people’s money – see the article [here](#).

### Is There a US Dollar “Rebound”?

D’oh! Please don’t be fooled: the “dollar rebound” theory can only move in my view those who still believe in Santa Klaus. Once more, the outcome of the “Fed versus global systemic crisis” saga will trigger a new stage in the collapse of the US currency. I can think of no one better than James Turk to demonstrate clearly that there is no such “rebound”.

The following chart of the Dollar Index clearly shows just how badly the dollar has been doing. There’s not even a “dead cat bounce” to be seen...



Here’s how James explains and comments on his chart:

*“Since reaching a peak in 2000, the Dollar Index has had only one major rally. From December 2004 to November 2005, the Dollar Index climbed 14.7%. This lone rally stands in stark contrast to the numerous double-digit jumps in the late 1980s and early 1990s, which is an important point. This difference to the earlier period signals a profound underlying weakness in the dollar.*

*There have of course been bounces along the way over the past eight years, but these typically are just a few percent. They recur periodically as the Dollar Index becomes oversold. We are in one of those moments.*

*The Dollar Index has bounced as high as 3.1% from its record low last month, but is now only 2.4% above that low. In other words, it looks like the Dollar*

*Index has started to slip again, which is to be expected. After all, no one in Washington is doing anything to improve the prospects for the dollar. There has been a lot of talk about the so-called "strong dollar" policy, but nothing is being done to bring it about.*

*The dollar is in a major bear market, and is losing purchasing power day after day because of debasement and inflation."*

By "inflation", he means of course firstly the increase in the money supply which grows at a rate which exceeds the rate of economic growth and therefore causes distortions and misallocations of capital that must eventually be unwound and secondly, the debasement of the currency and hence, ultimately, price increases.

Inflation is only getting worse, I'm afraid. That much, at least, should by now be obvious for all to see. But how much out of control it is becoming and how fast it's happening even surprised me last week when I went to the grocer and bought a loaf of bread and some milk (two litres). It cost me NZ\$10! Gee, no wonder we no longer have any pennies or nickels here...

### **Is This the End of a Fiat Currency Bubble?**

A fascinating presentation was delivered by Dr. Benn Steil at the New York Hard Assets Investment Conference, held earlier this month in New York. Dr. Steil is Senior Fellow and Director of International Economics at the Council on Foreign Relations in New York. He began his presentation by saying:

*"A lot of reporters ask me these days whether we're in the midst of a commodity bubble. In fact, next week I'm going to Washington to give a Senate testimony. Our good folks in Congress are examining whether we are in fact experiencing a commodities bubble driven by irrational speculation, and what we need to do about it.*

*My perspective is that the more interesting, and indeed more important, question to ask is whether we're at the end of what I would call a 'fiat currency bubble.' If we go back to the early 1980s, under the Volker effect, inflation, and at least equally importantly inflation expectations, were driven out of the system through a pretty ruthless policy of very tight money and high interest rates. And the period after that, the 1990s into the early years of this decade, I would really call the golden age of the fiat dollar."*

You can find his presentation [here](#).

Interesting comments and enquiry coming from someone high up at the CFR... I encourage you to read it in full on the web, if you want to gain a (most likely) new and informed insight on what's really going on in the behaviour of the 'money' world. What follows in the rest of this section are some of the things he said and that I find particularly interesting (any emphasis added is my own) and helpful in my endless quest for finding how this fiat monetary regime of ours since 1971 will end...

*"Is this Federal Reserve dedicated to price stability? Well, we have a Fed Funds Rate at 2%. We've got consumer price inflation at 4%; wholesale price inflation at 7%; a broad measure of U.S. money to supply growth. M3,*

interestingly enough, is no longer calculated by the Federal Reserve. We rely on private estimates going at around 17%. **It is not surprising that people around the world are beginning to lose faith in this fiat dollar.**"

So I think it's a mistake to characterize what we're seeing now as somehow a commodity's bubble. It may be in the grand historical sweep of things a return to normality; that may not be necessarily a good thing. The world of a responsible fiat dollar may very well be very desirable for all of us. But we have to ask, given the broad sweep of history, whether that's really possible. Okay, so what's at risk here? The first thing I want to establish for you is that the dollar really is very special in the international monetary system. It is very much the world's currency. About two-thirds of world trade is denominated in U.S. dollars, or virtually all international commodities trade denominated in U.S. dollars. Many countries around the world import U.S. monetary policy directly through payment fixed exchange rates. And why do they do that? Because they do almost all of their trade in U.S. dollars. **In other words, their interaction with the outside world is in U.S. dollars.** (...)

The U.S. dollar is the monetary standard, not only here, but for the rest of the world, and this makes our Federal Reserve unique. It gives it unique powers that no other central bank has.

But is the dollar a good store of value over a long period of time? What I've done in this particular graph is I've plotted the real effective exchange rate of the U.S. dollar, going back to the 1970s.



You'll see on the left side of the figure there is a big spike, which corresponds quite logically to the period of the Volker effect, where the Federal Reserve jacked up interest rates very high in order to restore the credibility of the U.S. dollar, and that explains the spike there. But broadly speaking, since the end of the Volker era, you see the trend has been downward. **The U.S. dollar has not looked like a great store of value** over, say, the past two decades. Much more importantly, it hasn't looked like a very good store of value **over the course of this decade, vis-à-vis hard assets.**

In [this next] graph, I plot the price of oil over the course of this decade. The top line is the price of oil measured in U.S. dollars. The middle line is the price of oil priced in Euros. And the bottom line? What you see is very flat. That's the price of oil and gold. And it's very - you see it's very, very flat.



And that shouldn't surprise people because as we go back to the era of the gold standard from about 1880 until the outbreak of the first World War, in 1914, prices around the world in countries that were on the gold standard were also remarkable flat. The figure looked just like this. **So gold is behaving as it has historically.**

Now, let's step back for a second, and ask what if the dollar became just another currency. What do I mean by 'just another currency'? I mean a currency that behaves like all the others, with a positive relationship between depreciation and inflation, and most importantly, between depreciation and interest rates.

In other words, if a currency depreciates, interest rates in the market go up. That's not science fiction. We're experiencing this right now. The Fed is pushing down very, very hard with short-term rates, the federal fund rates. But if you look at medium- and longer-term interest rates in the market, they are headed up.

What does that mean? **It means the Fed becomes impotent.** What do I mean by that? If you look at textbooks on macroeconomics, they explain the most important function of a central bank. Countries need a central bank because they act as lenders of last resort. That is, in a banking crisis, for example, when people panic about whether their savings are secure they would run to the bank to get their money out before the money disappears.

But the central bank can reassure them by printing money to make sure that the local banks, the private banks, have enough money to give back to the depositors. (...)

So, given that our Fed has been very much acting like a lender of last resort lately, trying to support liquidity in the market, participating in a bail-out of Bear Stearns, **people in this country may be beginning to get very nervous about this, about how much money is being printed.** And if they do become very nervous, they will ultimately behave just like people around most of the world. That is, when the Fed tries to behave as a lender of last resort, people will go to their financial institutions, withdraw their money, and then sell it for Euros or some other currency, or perhaps for hard assets. And if they do do that, the Fed no longer has powers of a lender of last resort. (...)

*If we were to become obliged to borrow in Euros and trade in Euros, then we would be subject to these same forces. I'm certainly not saying that this is around the corner, but in economics, we're always talking about tendencies: And it's a tendency that's important, and it's a tendency that we have to pay attention to in terms of adapting our policies. Finally, America begins to lose influence in the world. In terms of the value, the purchasing value of our economic aid, our humanitarian aid, our military aid; all of that will go down. It will buy us less influence in the world. **But think how the U.S. uses the fact that the dollar is such an important trade vehicle now, in order to disrupt the activities of our adversaries like Iran and North Korea. (...)***

*Now, what are the alternatives to the dollar that are out there? It's easy to say the dollar is at risk, but remember, we have to use something else if there weren't a hard dollar for us to trade in, and save in and borrow. I mean the obvious one is the euro. And indeed, if you look over the course of the decade so far, people have very much seen the euro as an alternative to the dollar (...)*

*But the euro has some real problems looking out long-term. (...) So the euro is not a natural alternative to the dollar, which probably means that the euro is not a particularly attractive direct alternative to the dollar. So what would come next?*

And, dear patient reader, HERE is where the speaker delivers the long awaited and least expected (coming from someone in his position) but most welcome PUNCH LINE:

*Well, if you go down the line of currencies around the world, you don't find many attractive opportunities. **And that's why I say if the world were to give up on dollars and give up on Euros, they'd probably go back to the old standby, which is gold.***

WOW! I had to read that again and again to make sure I was not having an out of body experience or something. He, of all people, was saying (much more eloquently than me) what I have now been more or less convinced was on the cards: a return of the global monetary system to the discipline of the gold standard. And this was not some 'gold bug', but a high ranked economist from an organisation that has been called the most powerful agent of US foreign policy outside the State Department!

There is hope for us all, after all, when someone in his position publicly states that we may finally have reached the point where people say "Enough. We've got enough of this stuff, and we don't trust your management of the dollar anymore." and admits that that's a very dangerous situation to be in. Halleluiah!

Hold on to your gold (and silver) and sit tight and, if you don't already have some bullion, get some!

*"At some point in this sequence will come the final break where the US Dollar loses its reserve currency status altogether. That will be seen when sellers of goods and services to the US demand that the US buyers make payment not in US Dollars but in Yen or Yuan or Euro. When that happens, it will mean that as a buyer, the US will FIRST have to buy the currency of the nation offering goods for sale before it can buy. No reserve currency nation has to do that.*

*The global arbiter of monetary value will be Gold. It will be the only money to value these currencies in."*

*- William A M Buckler*

*Captain of The Privateer, a private market letter for the individual capitalist  
The above quote is taken from the latest issue (see [www.the-privateer.com](http://www.the-privateer.com)).*

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#### **Page top**

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