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Axel Merk, Merk Investments, On Why He's Dissing The \$



Axel Merk

Axel Merk doesn't think much of the U.S. dollar, and he wants to put your money where his mouth is.

The German-born, Swiss-raised, and [Brown University](#)-educated fund manager founded [Merk Investments](#) in 1994. Now based in Palo Alto, Calif., his firm introduced the *Merk Hard Currency Fund* in May 2005, offering investors a no-load pure play on "hard" currencies, such as the euro, and gold, to protect against the falling dollar. Though the dollar hasn't fallen, Merk believes it's only a matter of time, and he is betting his \$60 million in assets under management that, over the long-term, the news for the dollar will not be good.

"We're trying to attract the person who is concerned with finding a safe place for their money, and who believes that dollar cash is no longer the safe haven it used to be," he says.

InstitutionalInvestor.com's [Jonathan Shazar](#) spoke with Merk about the state of the dollar, the U.S. economy and how Japan is destroying the yen.

InstitutionalInvestor.com: Why are you so down on the dollar?

Axel Merk: We have a dramatic current account deficit in the U.S., and that's the overwhelming drag on the dollar. Every day, foreigners need to acquire over \$2 billion, soon \$3 billion, of dollar-denominated assets just to keep the dollar from falling. That has been happening because it's been in the interest of the rest of the world to do that. The U.S. economy has ever greater leverage in it, and we have shifted the leverage to new extremes and we have now an economy that is highly interest-rate centered.

II.com: And that's an indication that we're at the end of a consumer cycle?

AM: Yes. The reason we think this is going to be the case long-term is because of both what I see in fiscal and in monetary policy... We have an entire economy geared towards being a spending machine, and there is nothing in sight that, from a fiscal point of view, will change that into a society that promotes saving and investment.

II.com: What do you make of the [Federal Reserve](#)'s statement that interest rate increases are coming to an ended sooner than predicted?

AM: The statement caught many people by surprise, and I don't trust the statement. If you read through it, you see the words brisk and vibrant, and all kinds of things that are typically associated with further tightening and further inflation. And then they are saying we are not going to raise rates many more times. I think the Fed is just talking to the market; they are more concerned about managing the yield curve than revealing what they're actually going to do.

II.com: How will the end of [Alan Greenspan](#)'s tenure, and the beginning of [Ben Bernanke](#)'s, affect the dollar and the economy?

AM: Bernanke will, I believe, follow in Greenspan's footsteps; he will tighten a little bit further. They'll tighten just enough so that we'll get into a recession, but not enough to contain inflation. Unlike the fed, I believe we have very serious inflationary pressures creeping up everywhere; everything that you cannot import from Asia is going up in price significantly... And, with everything that you can import from Asia, Asia is absorbing the additional burden of the high commodity prices.

I don't doubt the intellect of Bernanke, but I do doubt central bankers in general. They always believe they can master an economy, and they never can. Central banks think they have learned so much from history, and each time there's another problem popping up somewhere that didn't fit into their equation.

The main goal for the fed should be to kind of give Bernanke a free playing field, so that when he comes in he doesn't feel obliged to do things one way or the other. I think they were a little too strong with their statement, saying they were almost done; they're trying to tie his hands. Bernanke's almost obliged to go one step further than people expect him to, so he gets the reputation as a tough guy.

Il.com: So what should the Fed do?

AM: ... The dollar is politically the least painful avenue to try to keep this economy going. It's not just for the fed, it's also for the fiscal policymakers. How are you going to pay for Social Security and Medicare in the years to come? It doesn't look like there's an easier way than to destroy the purchasing power of the dollar. The problem is, if you go down that route, you may not be able to control how far it goes. You won't be able to stop it until you finally institute these reforms, and the later you institute them the more painful they will be. But that is the road the fed is going to go down.

Il.com: China recently said it plans to diversify its huge dollar holdings. Do you take that seriously?

AM: All these things are very small steps. China is very cautious, they know that if they move too rapidly, they might cause quite a panic. Then, last summer [CNOOC](#) wanted to acquire [Unocal](#). For once, the Chinese wanted to put all their dollar reserves to good use, and they were rebuffed. Why should you hold dollars if, when you want to use them for something useful, you can't do it?

Il.com: What about the rest of Asia?

AM: Unlike most people, I'm not very optimistic about the yen. There has been just a flood of liquidity in the market, and the Japanese are doing everything in their power to promote their exports; I believe that one day they'll get too much of what they're looking for and destroy their currency.

Il.com: You're very much the dollar bear. Are there any good signs for the dollar?

AM: The most attractive thing in the dollar's favor is that you can sell it. Also in its favor is that interest rates are still picking up.

One of the beautiful things about the economy here is that it is so flexible. People do change, partially because you have so much debt you have to find a job. And so, as you need to adapt, people do adapt. And so, companies can't hire people, so people start their own businesses. Many of them will fail, but some are the next [Googles](#). And the new economy companies, like Google, are doing great; they can live in this environment. But there is an ever bigger chunk of this economy that can't cope with the environment that we've created, and I believe that will be reflected in a very bleak outlook for the upcoming year.