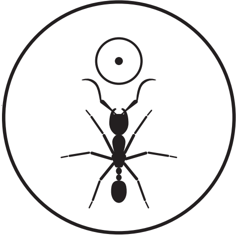

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The Gods of the Market Return

Proverbs advises: *Even a fool, when he holdeth his peace, is counted wise*. Lamentably, this option is unavailable to financial journalists assigned topics about which they know nothing. Case in point: *The Wall Street Journal's* Jason Zweig's recent screed against gold. Reproduced below is Myrmikan's letter to the editor submitted in response, which the *Journal* declined to publish:

> In "Let's Get Real About Gold: It's a Pet Rock," Jason Zweig disparages gold for not rising in response to China's stock market collapse or the news out of Greece. He compares gold owners to "subjects of a laboratory experiment" and cites Scripture to assert that owning gold is "an act of faith."
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> Dismissing four millennia of monetary history is nothing new. The Duke Saint-Simon observed of the Mississippi Bubble in 1719: "it was pretended that since the time of Abraham—Abraham, who paid ready money for the sepulcher of Sarah—all the civilized nations in the world had been in the greatest error and under the grossest delusion, respecting money and the metals it is made of; that paper alone was useful and necessary."
>
> Gold is not an investment; it is the ultimate money, and it is so because it has the most stable value. Since Nixon detached the dollar from gold in 1971, for example, the annual standard deviation of oil in dollar terms has been 64%, whereas in gold terms it has been only 40%. Gold also preserves value through time: since 1792 gold has increased in value against commodities by half a percent per year, on average.
>
> Gold's stability makes it the best reference point for other prices. During credit bubbles, when prices soar, gold will underperform. On the other hand, gold always outperforms in the bust as prices collapse, the reason why holding gold is currently so timely.

Compare Saint-Simon's words with a passage penned a century later by Albert Gallatin, the longest serving Treasury Secretary in our nation's history, at the beginning of another credit bubble:

> We learn from the most ancient and authentic of records that Abraham was rich in cattle, in silver, and in gold; that he purchased a field for as much money as it is worth, and in payment weighed four hundred

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> shekels of silver, current (money) with the merchant. And when we see that nations, differing in language, religion, habits, and on almost every subject susceptible of doubt, have, during a period of near four thousand years, agreed in one respect; and that gold and silver have, uninterruptedly to this day, continued to be the universal currency of the commercial and civilized world, it may safely be inferred that they have also been found superior to any other substance in that permanency of value which is the most necessary attribute of a circulating medium, in its character of the standard that regulates the payment of debts and the performance of contracts.

Author Garet Garrett explained precisely why gold makes good money in 1932, in the aftermath of yet another credit bubble:

> The value of gold is arbitrary; so is the length of a yardstick. But just as it is necessary to sell cloth by the yard or coal by the ton, so it is necessary to have some arbitrary unit of value in which to price the yard of cloth and the ton of coal. It would be ideal to have something of absolutely invariable value in which to price them. But there is no absolutely invariable thing in the world. The relative constancy of the gold supply, the durability of the metal, the fact that over the centuries the amount of human exertion necessary to get it out of the rocks changes very slowly—for these and other reasons gold is the least unstable thing man has found for purposes of money, hence his preference for it.

Yet, during credit bubbles, fools become persuaded that paper alone is useful and necessary. Consider the following report of a legislative committee investigating the effects of a bubble:

> In defiance of all experience, and in contempt of warnings almost prophetic, the inclination of a large part of the people, created by past prosperity, to live by speculation and not by labor, was greatly increased. A spirit in all respects akin to gambling prevailed. A fictitious value was given to all kinds of property. Specie [gold and silver] was driven from circulation as if by common consent, and all efforts to restore society to its natural condition were treated with undisguised contempt.

The year was 1819, but these words could have been penned in the aftermath of any of the hundreds of credit bubbles that have afflicted the world since the advent of fractional reserve banking.

Undisguised contempt—what words could more accurately describe what modern economists heap upon the prophetic warnings of those who support sound money? In recent times:

> The notion of credit which prevailed was that it was a way of making formulas of words do the work of capital, if only the formulas were imposing enough, or were uttered by a body having competent prestige.

These lines were published by William Graham Sumner in 1896. No, he was not prophesying America's current condition; he was recording our colonial history, when the states for sixty years switched to a fiat currency standard in defiance of Parliament. The future, final Royal Governor of Massachusetts, Thomas Hutchinson, recorded the result:

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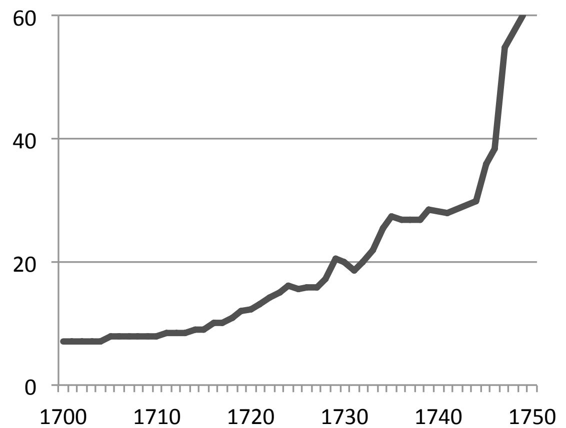
> The depreciation was grievous to all creditors, but particularly distressing to the clergy and other salary men, to widows and orphans whose estates consisted of money at interest, perhaps just enough to support them, and being reduced to one-half the former value, they found themselves on a sudden in a state of poverty and want. Executors and administrators, and all who were possessed of the effects of others in trust, had a strong temptation to retain them. The influence a bad currency has upon the morals of the people, is greater than is generally imagined. Numbers of sherries, for private and public emissions of bills, were proposed as remedies, the only effectual one, the utter abolition of the bills, was omitted.

Exchange Rate of Massachusetts Bills for Sterling



Parliament finally put a stop to it in 1750; but, when the revolution freed the states from restraint, they immediately turned back to money-printing: “Do you think, gentlemen,” charged one Congressman of the Continental Congress, “that I will consent to load my constituents with taxes, when we can send to our printer, and get a waggon load of money, one quire of which will pay for the whole!”

The result was one of the very first, true hyperinflations. The “continental” became worthless. The course of the inflation was as it ever has been—Daniel Webster lamented:

> Frauds, cheats, and gross dishonesty are introduced, and a thousand idle ways of living are attempted in the room of honest industry, economy and diligence which have heretofore enriched and blessed this country.

Speculators win. “No one is known ever to have lost anything by a purchase and sale of real estate” gloated one in 1836, at the peak of a bubble. “Well, I guess I don’t buy your premise. It’s a pretty unlikely possibility. We’ve never had a decline in house prices on a nationwide basis,” echoed Lord of the Speculators Ben Bernanke in 2005 when asked if housing prices were in a bubble.

Workers lose:

> Wages appear to be among the last things that are raised by an increase of Bank medium. The working man finds all the articles he uses in his family rising in price, while the money rate of his own wages remains unchanged.

These words, written in 1831, testify that economists have known for centuries that increasing credit transfers wealth from laborers to speculators, forcing the conclusion that Federal Reserve economists are complicit, ignorant, or likely both.

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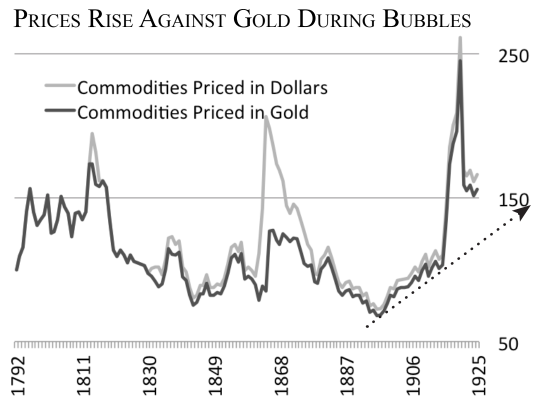
But the end will come. Eventually the economy must collapse under the weight of misaligned investment induced by credit:

> Every one now talks in thousands; nothing is heard but gigantic operations in trade; great purchases and sales of real property, and immense sums made at every transfer. All, to be sure, as yet exists in promise; but the believer in promises calculates the aggregate as solid capital, and falls back in amazement at the amount of public wealth, the "unexampled state of public prosperity."
>
> . . . [Then,] the coinage of words is suddenly curtailed; the promissory capital begins to vanish into smoke; a panic succeeds, and the whole superstructure, built upon credit and reared by speculation, crumbles to the ground, leaving scarce a wreck behind: "It is such stuff as dreams are made of."

Washington Irving wrote those lines in 1819. A century later, America entered what contemporaries called—without a hint of irony—"a new era" of "permanent prosperity."



The most outspoken advocate was Irving Fisher, whom Milton Freidman called "the greatest economist the United States has ever produced." Fisher condemned the gold standard in favor of a managed currency, and in 1920 published a graph similar to the one at right to show that "as compared with the biggest dollar we ever had, that of 1896, our present [gold] dollar 'looks like thirty cents.'" What he didn't realize was that he was writing in the midst of the greatest credit bubble the world had yet seen.

The lower chart shows what happened next. The malivestments liquidated in a great depression, and prices came crashing down.

It is on this point that Jason Zweig demonstrates his foolishness. Compared with China's stock market collapse and softness in U.S. market, gold wins by just staying flat. Gold miners are not seeing their revenues increase; rather, the collapse in indusrtial commodities is causes costs to collapse, just as it did in the Great Depression.

The lower chart also demonstrates that, except when interrupted by government induced credit bubbles, prices in gold terms move relentlessly lower. Technology

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improves, things get cheaper. Note the logarithmic scale: the straight trendline on a logarithmic scale means things get cheaper by a certain percentage per year. Since 1784, for example, copper priced in gold has declined 0.6% per year on average, wheat by 0.9%, and cotton by 1.6%. The prices of products made from these and other commodities fall even faster. And Zweig says that gold has no yield!

These yields may not seem high, but they are in real terms, are persistent, avoid income taxes, and do not require large fees be paid to money managers. Of course an astute investor can make more money in the market, investing in companies that design and make the products that improve our lives, but investing entails added risk. Gold bullion entails no fees and no counterparty risk. It is the ultimate cash, the final refuge against Keynesian foolishness and the collapse of market bubbles.

Conservative savers do not flourish during the growth of a credit bubble; instead:

> Now is the time for speculative and dreaming or designing men. They relate their dreams and projects to the ignorant and credulous, dazzle them with golden visions, and set them madding after shadows. The example of one stimulates another; speculation rises on speculation; bubble rises on bubble; every one helps with his breath to swell the windy superstructure, and admires and wonders at the magnitude of the inflation he has contributed to produce.

Irving Fisher lived these lines of Washington Irving, declaring right before the great crash of 1929 that stocks had reached a "permanently high plateau." When the promissory capital vanished into smoke, Fisher lost his considerable personal fortune, prompting him to pen an academic version of Irving's lines:

> Practically every period of economic hope and promise has been a mere inflationary boom, characterized by an expansion of the means of payment, and has been followed by a depression, characterized by a detrimental contraction of the means of payment. In boom times, the expansion of circulating medium accelerates the pace by raising prices, and creating speculative profits. Thus, with new money raising prices and rising prices conjuring up new money, the inflation proceeds in an upward spiral till a collapse occurs, after which the contraction of our supply of money and credit, with falling prices and losses in place of profits, produces a downward spiral generating bankruptcy, unemployment, and all the other evils of depression. . . Fractional reserves give our thousands of commercial banks power to increase or decrease the volume of our circulating medium by increasing or decreasing bank loans and investments.

Indeed, this is precisely how it works, how it has worked for millennia, and how it will continue to work as long as the government protects the fractional reserve banking model. In the upswing, prices soar in terms of free market money. Our contemporary ignorance and pride imagines at such times that gold is falling in price. Then, values come crashing down, and gold soars, either in nominal or real terms.

The only thing novel about the current credit bubble is its scale. All the dynamics are the same. Paper is exalted, gold is disparaged. Speculators prosper, workers languish. Savers are beguiled, capital is malinvested.

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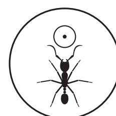
As with every credit bubble, investors must once again choose whether the techniques of smooth-tongued, prestigious bankers have permanently supplanted the wisdom of the ages, whether credit that has breached its bounds must be balanced by contraction, or, instead, whether the wizardry of Krugman and Keynes have indeed brought us a permanent era of unexampled prosperity.

Until 1971, a mere forty-four years ago, it would have been correct to repeat Gallatin's lines: *during a period of near four thousand years . . . gold and silver have, uninterruptedly to this day, continued to be the universal currency of the commercial and civilized world.* In fact, one could argue these lines are still true—the chart above demonstrates that prices continue to fall against gold, and civilized people continue to preserve their core savings in gold, while they wait.

> *Then the Gods of the Market tumbled, and their smooth-tongued wizards withdrew*
> *And the hearts of the meanest were humbled and began to believe it was true*
> *That All is not Gold that Glitters, and Two and Two make Four*
> *And the Gods of the Copybook Headings limped up to explain it once more.*
>
> *As it will be in the future, it was at the birth of Man*
> *There are only four things certain since Social Progress began.*
> *That the Dog returns to his Vomit and the Sow returns to her Mire,*
> *And the burnt Fool's bandaged finger goes wabbling back to the Fire;*
>
> *And that after this is accomplished, and the brave new world begins*
> *When all men are paid for existing and no man must pay for his sins,*
> *As surely as Water will wet us, as surely as Fire will burn,*
> *The Gods of the Copybook Headings with terror and slaughter return!*

Rudyard Kipling published these lines in October of 1919. The World War I bubble peaked on November 3; by mid-1921, stocks prices had fallen by half. Charles Hamlin, the first head of the Federal Reserve, had promised in 1915: "Under the Federal reserve system we shall have no more financial panics." A poet knew better.



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