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Kings World News Blog

Money, The Real Stuff

Ben Davies CEO Hinde Capital recently featured on Kings World News Broadcast published an op-ed styled piece at the Kings World News Site

Money, The Real Stuff
Ben Davies CEO Hinde Capital

“The extent of the power of money is the extent of my power. I am ugly, but I can buy for myself the most beautiful of women. Therefore I am not ugly, for the effect of ugliness – is nullified by money” - Johan Wolfgang von Goethe

The power of money is so beguiling, yet so elusive to most us mere mortals. It shapes our lives, for many of us our every waking thought. If asked, most people will always say, “I want more money”.

Frank Sinatra croons, “Who wants to be a millionaire?”. No Frankie, nowadays we want to be *billionaires*.

Twenty years ago, according to the *Forbes' Rich List*, there were 140 billionaires. Three years ago there were almost 500. This year there are close to 800, each with an average net worth of \$3.3 billion. Why the surge? The ‘invisible hand’? No. Animal spirits? I doubt it. Did the world just get 8 times more get-up-and-go? Hardly. So what then? Money, that’s what.

Globally, living standards and wealth have been on the rise even for the poor, primarily based on ‘cheap’ or ‘easy’ money. Debt has been offered at low interest rates. All this debt is money. Money which has funded an illusion.

Like Goethe’s Faust, we made a pact with the devil. Easy money fulfilled all our wants, we all wanted to live like billionaires, to seduce our women (or men). Like Faust payment time arrived. The year was 2008, the year of the ‘Debt Crisis’. Mephistopheles came knocking at our door. Easy money had expired and with it all the accompanying illusions of wealth.

Or so we had thought. For many the Faustian dream is still intact. The ‘no payment down - no questions asked’ lifestyle lives on. Little has changed. We wanted more money. We have got it, but at what cost?

Our modern day Mephistopheles comes in many guises. He is the national treasurer issuing debt or IOUs to the central bank. He is the central banker who swaps said IOUs for paper money he summons out of thin air. He is the politician who then offers you unlimited social security, housing benefits and free medical care, with this very same debt.

Mephistopheles is like a drug dealer offering solace to his flock of crack addicts. Government, confronted with looming recession, chooses the quick fix of more debt, piled on top of the mass that already exists, by which to lessen the pain. The government must offer more debt, but like a drug dealer short on supplies he can only offer a more impure version.

As a nation we have been living on debt paid for by watered-down money for decades, but so subtle was it at first, we were none the wiser. But when the pain of addiction began to be felt in 2008, we began to understand the lie. And then we went searching for the real stuff.

Money for sometime has been worth what government decrees it to be worth. We trust in our duly elected government and unelected central bankers not to subvert the value of our money. It is the value of our day's labour, by which some is paid in taxes to fund our social obligations.

Unfortunately when it comes to control of money, government can rarely be trusted. As George Bernard Shaw put it, "The most important thing about money is to maintain its stability . . . You have to chose between trusting the natural stability of gold and the honesty and intelligence of members of the government. With due respect for these gentlemen, I advise you, as long as the capitalist system lasts, to vote for gold."

Our watered-down money has had its purchasing power diluted. At first this new money supplies us with more goods. Initially we feel rich as we have 'more' money. But as we rush out and spend our surplus money, prices rise.

Nobody invented money. It evolved naturally from our desire to exchange goods and services. A barter system posed no end of complications. Divisibility – how many chickens for half a cow? Coincidence of wants – do I really want a cow instead of chickens, when in fact I want a horse.

All manner of commodities served at times as money: salt, shells, wooden sticks, tobacco, cotton or even cattle. Indeed the word pecuniary comes from the Latin *pecus* – meaning cattle. The only thing that really makes money "money" is its ability to serve as 1) a means of exchange, 2) a unit of accounting and 3) store of value.

In a paper money world the existence of money rests on a single convention – *faith*. This faith is no fragile concept. Even under the greatest provocation of the medium's validity, the value of having a common money is so great that individuals will stick to that faith.

But now people are beginning to lose faith in our watered-down money and have turned to real *geld* - as the Germans would say - real money: gold.

What should you make of the recent stampede to own gold? A detached observer might be puzzled by the obsession to own the yellow, shiny stuff. Warren Buffett once wryly observed, "It gets dug out of the ground in Africa, or someplace. Then we melt it down, dig another hole, bury it again and pay people to stand around guarding it. It has no utility. Anyone watching from Mars would be scratching their head".

Buffett's response is too smart by half. A Martian would be equally puzzled to see humans cut down a \$100 tree in order to pulp it, turn it into paper, print numbers on the paper, and pass it off as dollar bills worth \$1 billion.

Gold antagonists claim that gold is a Ponzi scheme. Its value continuing to rise, they say, depends on people willing to buy it at higher prices from previous buyers. This is to misunderstand the nature of gold. It is not just another commodity. Gold was once money, and no doubt will be again. The last four decades are the blip in time when money has not been backed by gold.

Money has not been redeemable in gold since Nixon in 1971 shuttered the Gold Window and reneged on De Gaulle's payment request for goods with gold, and instead settled in increasingly worthless dollars. No single act this past century has undoubtedly paid testimony to gold's true worth. A resounding vote of confidence for the real stuff.

Eventually the real stuff will end the reign of the dealer who supplies the watered-down version. Like all good egocentric politicians to lose your vote later is infinitely preferable to sooner. So until the real stuff is accepted by all, the government will keep peddling their watered-down money. And when asked if it's dirty, they will deny, deny and deny again.

So again the question is: why is gold going up in price? Most individuals have assumed that paper money - euros, dollars, Chinese yuan, Brazilian real or even Mexican pesos - has done a good job as a means of exchange and unit of account.

The near implosion of the financial system in 2008 changed this assumption. Watered-down money was created at an unprecedented rate to prevent the system from complete cardiac arrest. One of money's primary functions - as a store of value - came in to question. Individuals sought alternatives. Gold was one of them.

The gold detractors - after getting it wrong about gold - have been watching in disbelief as its price has doubled in 3 years. They now proclaim gold is overpriced and it is in a bubble, and one that is about to burst.

The anti-gold crowd are right insofar as they have identified a bubble. It is not, however, in gold. Rather it is paper money, in which gold happens to be priced, that is the bubble. Compared to watered-down money, gold looks much undervalued.

If you think this is ridiculous, consider this: in 1980 a house in central London cost 180 troy oz of gold to purchase. Today, that very same house will cost you nearly 5,000 troy oz. So in spite of record values for property and three fold increase in gold prices, gold is still undervalued.

Gold has a price and a value. Price is a level at which you make an exchange, and value is whether it is worth it. Right now gold is at a high price, but when examined in the context of other assets it remains undervalued.

As gold's value rises or, more accurately, as paper money's value falls, what we are seeing is an incremental return of gold to a monetary asset. The fact remains that the subtle confiscation of your day's labour by issuing watered-down money has only begun to dawn on the populace. They are only just waking up to gold as money.

Governments today are struggling with thumping budget deficits, so the risk of further money printing looms large. With gold already undervalued, its outperformance will only accelerate further.

A German banker once said that gold normally trades like a commodity. However, he also said when investors lose confidence in currencies, because the pool of gold is so much smaller than the pool of currencies, demand for gold can effectively become unlimited.

Germans are wise men. Not least Goethe who was as remarkable as he was wise. So remarkable the German national assembly was drawn to his home city to draft the constitution of a new republic. The new republic was the Weimar Republic and the year was 1919.

So indebted was Germany after the Great War, and faced with more economic pain, Rudolf von Havenstein, the Reichsbank Governor, chose to print more money to fund the deficit. Much as Mervyn King and Ben Bernanke have been praised for their efforts to combat economic turbulence over the last two decades, Von Havenstein won plaudits for his earlier World War I monetisation efforts. His later actions, culminating in the German hyperinflation of the 1920s, were of course far more infamous.

One does not want to overplay the parallels, but as was the case then, today's central bankers are offering us a similar pact. Print money and all your troubles will disappear. We have lost the ability to fund our debts, as most other countries are in the same predicament. We asked for more money and we got it. Keep the faith and we will all be billionaires, but we must be careful what we wish for.

Gold is telling you so much more about itself than just its price. It is telling you the government is losing credibility to maintain the value of fiat money. They will deny it; but as Abraham Lincoln opined: "You can fool some of the people all of the time, and all of the people some of the time, but you can not fool all of the people all of the time".

Be one less a fool, own some gold.