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Dollars and Gold

A Monday Morning Musing from Mickey the Mercenary Geologist

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I am a concerned American citizen and an unwilling taxpayer. I'm concerned because these piecemeal government bailouts continue unabated at the citizenry's expense. The United States government should either nationalize the banks or simply let them fail. As a student of Austrian economics, I prefer the latter but in reality that has a snowball's chance in hell of happening. Piecemeal infusions of dollars only serve to prolong the agony of a dysfunctional economy.

Monetization of Treasury bonds to the tune of $300 billion will not be nearly enough to solve our country's financial problems but it is enough to placate the Chinese for now or at least shut them up for awhile. We can surmise what they whispered in Billary's ear while she was getting the cold shoulder in Beijing about a month ago.

In the meantime, Obama 'n Biden and the Congress have decided to express their outrage over a few AIG bonuses to deflect criticism from the real issue: $1.5 trillion dollars in government-funded bailouts.

Don't get me wrong. I object to these bonuses as much as anyone but they are unimportant in the grand scheme of things. Let's examine how this worked:

The Executive comes to Congress screaming "World financial collapse imminent unless we act immediately and decisively." Congressmen without bothering to read the bill vote for taxpayers to "loan" $170 billion in bailout dollars to AIG. This monopoly money is then created by the Fed with a few strokes of the keyboard. AIG gives $165 million (less than 1/1000 of the new money created) to its executives as retention bonuses. After all, these are indispensable employees in great demand in the world of financial engineering. Who else could they find to perpetrate the chicanery of their toxic credit default swaps and collateralized debt obligations? These derivative instruments were so efficiently disseminated thru out the world that even a municipality in Norway went bankrupt.

Our illustrious *Parliament of Whores* then turns on a dime (soon worth a penny) and votes to tax these executive bonuses at 90%. The money comes from the government and then goes back to the government full circle.

In reality this is simply a giant money-laundering scheme with the Federal Reserve creating the money, the government doling it out to the Banksters, and the legal beagles, the bean counters, and the bureaucrats skimming their per cent off the top at every opportunity. The net result is the ordinary citizen who has worked hard and long to get ahead suffers with lessened buying power, higher taxes, and an uncertain future as an elder.

If an average citizen was to perpetrate such a scheme at even one millionth of the $1.5 trillion dollars in bailout money, he soon would witness the black shirt Storm Troopers (aka the multi-jurisdictional SWAT team) bash down his front door with a battering ram, throw him on the floor and then into jail, blast open his safe, confiscate his guns, gold, and rainy day dollars, slap liens on his cars, boat, house, and summer vacation home in the mountains, freeze his bank accounts, and charge him with money laundering, conspiracy to defraud the government, and tax evasion.

This is our government and it is unholy.

But it was freely elected, it is a hand we have dealt ourselves, and as investors, it is the hand we must play. For those of us with investment in hard assets, the question becomes: What does the monetization of US bonds bode for the price of gold?

- It leads to volatility in the gold price that is simply amazing. I watched gold soar from $892 an ounce to $928 an ounce in a matter of six minutes on Wednesday afternoon.

- The monetization of debt is simply massive currency inflation. Weimar Ben Bernanke first embraced this thesis in his 1979 Ph.D. dissertation at MIT on the Great Depression.

- The net result of an inflated US dollar is simply devaluation of consumer buying power. This is positive for the price of gold in US dollars.

- However, in real terms, gold will not gain but will only retain its constant buying power.

As you are aware, I am not a gold bug. I am a gold bull and I still do not think that gold is going to $2000 or $5000 as the perma-bull gold bugs have been preaching to their own choirs since 1981.

Gold cannot be breathed, drank, eaten, provide shelter, or run your internal combustion engine. It is not used for anything that is essential for survival. It is simply a store of value. According to Aristotle, gold is the perfect money and it has been used as a primary store of wealth and value by many cultures for thousands of years.

Gold has value today because it can be exchanged readily for paper money which then is used to purchase the essentials of life. It has unique value because, like no other monetary instrument, there is a limited supply in the world (as opposed to all fiat currencies) and there is no significant industrial or agricultural use (as opposed to all other commodities). An estimated 95% of all the gold mined in the history of mankind is still hoarded above ground or is shallowly buried in vaults, safes, or PVC pipes.

Gold is money.

However, as with all commodities, the short term market price of gold is controlled by supply and demand.

The increase in the price of gold since mid-November 2008 can be attributed solely to investment demand. In mid-Q4 2008, money managers, brokers, and individual investors looked at the financial turmoil, their devastated brokerage accounts, housing values, and 201K's, reviewed what investments had retained most of their value during the previous year, and recognized that there was only one: Gold.

The general populace finally came to that realization that gold is the ultimate safe haven investment.

As a result, speculative and safe haven dollars have poured into the gold market, mostly into paper gold thru ETF's and to a lesser extent, the physical gold market. European central banks, bound by worldwide agreement to limit their sales on the open market, have not sold any gold. Other sovereign central banks, specifically Russia, Venezuela, and Ecuador have become significant buyers of gold, mostly from domestic producers in the first two instances.

Countering the investor buying frenzy is very low demand for jewelry. Sixty percent of the world's annual supply of gold normally is taken up by jewelry fabrication. That market has nearly collapsed in India and the Middle East, traditionally the world's largest consumers. It's no better in the USA. Jon Nadler recently entitled one of his daily missives: "No Sales at Zales."

In addition, scrap gold sales have skyrocketed. Refiners are overwhelmed by the current supply being driven by, among many others, Ed McMahon's pitch of "Cash4Gold" to the financially-challenged and debt-ridden American.

With all these swirling countercurrents, we can be certain of two things: Gold will continue to be a volatile commodity and the price will not take a nosedive. The primary determinant of gold price will always be inflation of the money supply (government printing of dollars) in relation to the inflation of gold supply (mine production). However, gold, like all commodities in a capitalistic society, will continue to trade up and trade down depending on supply, demand, and investor sentiment and likely will trade within a well-defined range for the next year.

Gold is simply an insurance policy and safe haven to protect against an uncertain economic future, financial calamity, and worldwide economic collapse. It makes no difference whether that might occur within a deflationary or inflationary context.

This is the very reason that I continue to urge family and friends to own physical gold. Please get off your can and buy some gold. If you didn't do it yesterday, do it today, don't wait for tomorrow. The price is irrelevant no matter where you live and what fiat currency burdens you.

A 10-20% portion of any financially viable family's net worth should reside in physical gold. Tuck it away and forget about it (but not where you tuck it!) until it is needed to provide for you and yours or to pass on to your children and grandchildren.

Folks, please remember the Golden Rule: He who has the Gold makes the Rules.

I will add my Mercenary addendum to that wise thought by an unknown sage:

If the world goes to hell in a hand basket, you must own physical gold. Rest assured that the world will not be a pretty place if that unlikely scenario comes to pass. However if it does, I suggest you also own a gun and know how to use it.

In turbulent times like these, it is best to subscribe to the Boy Scout motto: Be prepared.

Ciao for now,

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The **Mercenary Geologist Michael S. "Mickey" Fulp** is a Certified Professional Geologist with a B.Sc. Earth Sciences with honor from the University of Tulsa, and M.Sc. Geology from the University of New Mexico. Mickey has 30 years experience as an exploration geologist searching for economic deposits of base and precious metals, industrial minerals, uranium, coal, oil and gas, and water in North and South America, Europe, and Asia.

Mickey has worked for junior explorers, major mining companies, private companies, and investors as a consulting economic geologist for the past 22 years, specializing in geological mapping, property evaluation, and business development. In addition to Mickey's professional credentials and experience, he is high-altitude proficient, and is bilingual in English and Spanish. From 2003 to 2006, he made four outcrop ore discoveries in Peru, Nevada, Chile, and British Columbia.

Mickey is well-known throughout the mining and exploration community due to his ongoing work as an analyst, newsletter writer, and speaker.

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