



Strategy Update

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The Destruction of the [Bretton Woods Agreement](#)

During the latter part of World War II, delegates from the forty-four Allied Nations gathered at Bretton Woods, New Hampshire to create a new world system of monetary management. A key aspect of this new agreement was the maintenance of currencies within a very tight range in relation to the price of gold. The International Monetary Fund was simultaneously established to act as a buffer to bridge temporary imbalances of payments. President Nixon formally abandoned this Agreement in 1971 when he suspended the convertibility of the U.S. dollar into gold. Since that event, the United States has been creating what is called *fiat money* with increasingly reckless abandon.

There is a rich history leading up to that 1971 event. During the 1930s, President Roosevelt confiscated the gold in the United States as one of the measures related to stemming the panic in the banking system. At the time of the confiscation, gold was forcibly redeemed at \$20.67 per ounce. According to one source, Roosevelt knew that he could not prevent foreign holders from redeeming the dollars, so he eventually allowed a return to dollar-to-gold convertibility for foreigners later in that decade, but at the much higher rate of \$35. This was a substantial devaluation of the U.S. dollar. It remained illegal for U.S. citizens to hold more than an insignificant amount of gold.

There has been a belief that one of the secret aspects of the Bretton Woods Agreement was the maintenance of a cartel of central banks that has been manipulating the price of gold since 1944. Once considered a belief only of conspiracy theorists, it has now been established as fact by the [declassification](#) of secret documents. The cartel was and is a reality.

It makes sense. If one prints currency that is simply paper (and is now mostly electrons), you must maintain the belief that it is usable as a store of value, whether for conducting a transaction or for holding for longer-term purposes. As the “canary in the mine shaft,” the price of gold cannot suddenly break out to the upside without holders of the paper or electrons worrying about the validity of the currency, let alone creating a panic to exchange it for physical assets of some kind.

The system worked reasonably well until 1965. The United States then faced a problem similar to the one we face today. In those days, it was referred to as the “Guns vs. Butter” debate: how do we simultaneously pay for the Great Society (a set of domestic programs enacted by President L.B. Johnson) as well as the Vietnam War? The truth was that we could not.

Our leaders resorted to the solution that has been tried repeatedly throughout history, debasing the currency.

The first step was the [Coinage Act of 1965](#). This act allowed the government to eliminate silver from dimes and quarters and to severely diminish the amount of silver in half-dollars. The market price of silver had already begun to rise, most likely in response to the budget and balance of payments problems alluded to above.

An article from the February 12th issue of [Time Magazine](#) detailed the frustrations and communications expressed at the time, particularly from French president Charles de Gaulle. It was significant for de Gaulle to go public with his comments, as France was part of the post-WWII cartel suppressing the price of gold. De Gaulle and France went from being a seller to a buyer of gold. One source said that de Gaulle sent the French Navy to New York, on at least two occasions, loaded with paper currency to be exchanged for gold bullion. Ultimately, it was de Gaulle that forced President Nixon’s hand in 1971 to suspend convertibility. This effectively ended the Bretton Woods Agreement.

The Inflation Begins

In 1965, President Johnson signed the Coinage Act. In his speech upon signing the bill, he virtually threatened American citizens not to use silver as a store of value. He knew that he was covered on gold as it was still illegal to own, and the Cartel was still mostly intact. There were also the official gold holdings: a powerful weapon to be used in the fight to control the price. Johnson had a reserve of what was estimated to be 600-plus million ounces of silver to use against any price increase if his threat was not heeded.

To fund the Great Society and the Vietnam War, the Government began to print money. Contrary to conventional wisdom, the inflation that manifested itself in the mid- to late-70s had its roots in the printing of money that began in this timeframe. Wages started to increase in the latter half of the ’60s, de Gaulle forced us off of the gold standard in 1971, and the Arabs dramatically raised the price of oil shortly thereafter. At the time, the Arabs complained that they did so to offset the loss of purchasing power for the dollars they were receiving. It was probably the truth.

The root cause of inflation is currency depreciation. However, it works with a significant lag in time. Modern pundits point to the lack of inflation as to why gold and silver should not be valued at current levels. They cannot explain why gold has more than quadrupled without such headline inflation.

There is inflation out there. The reason that we have not experienced it yet in the current recession is that we have a trading partner that has been exporting cheap labor and manufactured goods. That partner is China. For domestic reasons, it has been an important goal to provide employment and to build a world-class manufacturing capability. In the process, the input costs have been suppressed, and that benefit has been exported to the U.S. in the form of lower-priced goods. Therefore, an important factor in the apparent lack of inflation is that we have been subsidized throughout most of this decade. This is particularly striking given that the Cartel has been doing its best to suppress the price of gold and silver along the way.

The Chinese cannot directly offset the input costs that we directly import such as oil. Therefore, we did get a short, but painful look two summers ago at what could be around the corner as the price of oil created \$5-per-gallon gasoline. Home heating oil prices also skyrocketed.

The inflation is out there and will eventually be unleashed.

Debasement of the Dollar

The Bretton Woods Agreement allowed for the U.S. dollar to be the reserve currency for the world. Instead of owning gold, which pays no interest, must be stored, and is physically impractical to move around in a dynamic global economy, paper and now electronic dollars became an ideal intermediary between real goods and services as well as a store of value. Inflation has existed forever, but interest rates were set over time to adjust for it. Therefore, one could earn a real rate of return on fixed income despite the inflation.

As long as the number of dollars that are created relative to the amount of gold, real goods, and real services grows in some form of equivalency, the system should function properly. Having the status of the world's reserve currency was immensely valuable to the U.S. It was also a great responsibility. Starting in 1965, we abused that responsibility.

The Great Society, like all government entities since our founding, allowed politicians to make promises vastly in excess of our ability to pay. We have been running the biggest [Ponzi Scheme](#) in the history of the world, and it appears about to unravel.

According to [the U.S. Debt Clock web site](#), our total actual and accrued liabilities are approximately \$106 trillion and growing. Needless to say, we do

not have anywhere near that amount of money to fund the liabilities. It represents the invoice for promises that have been made over many decades.

We see some good news in the statistics. The National Debt is around \$12 trillion. Of that amount, about \$3.5 trillion is owed to foreign governments. The U.S. is still a country rich in resources, technology, and people. We can handle that amount of debt.

Of the remaining \$12 trillion, one writer suggests that most of that debt is represented by the I.O.U.s that the government has been issuing since they confiscated our payroll taxes to fund Social Security, Medicare, etc. Those are debts owed by us to ourselves. We can handle that, too, given enough time and hard work.

Social Security is around \$14 trillion. We can pay for Social Security as well. The real problems are the prescription drug and Medicare liabilities. Those are \$18.5 trillion and \$73.7 trillion, respectively. The former was only created this decade, and it already surpasses the Social Security obligations.

Clearly, this type of debt accumulation is insane. We have deluded ourselves into making promises that are way beyond the realm of rationality. There is no amount of taxation including complete confiscation that can address those numbers.

So what are the choices? The most desirable is to admit that we have been behaving poorly and scale back the commitments to something practical and within our means. Unless we do that, only two choices remain: default on the obligations or embark on a massive printing of money to destroy the value of the obligations. Both actions have been done before, but the former is extremely problematic given our current role as steward of the world's reserve currency. If we destroy our currency we will suffer mightily. However, we will also take down the savings of the rest of the world at the same time.

The rest of the world has already figured out this consequence. Several changes have occurred. First, there have been loud voices for an end to the dollar's role as the reserve currency. Such talk could never have occurred even a few years ago. Russia and China have been two of the biggest proponents despite their occasional denials that there is an alternative to the dollar.

It is unlikely that we can return to the gold standard at current prices. There is just too much fiat money in the world economy. One source estimated that all of the gold ever found is worth around \$5 trillion. That same source calculated that governments around the world committed to over \$20 trillion in stimulus packages just within the last year. The supply of gold grows a modest 1–2% per year, so there will be no major increases in supply. Therefore, we would guess

that the price of gold would have to be set at some number in the \$10,000 range per ounce to make it viable again for a new monetary system.

In the absence of just the gold alternative, countries and individuals have been turning to commodities, equities, and other real assets. There is a glut of oil, for example, yet the price has increased dramatically from the low. Most likely, this price increase is the conversion of the paper/electronic money into a new store of value. Other commodities such as copper have also seen major price increases. If it were commodities in general, the price of natural gas would have followed, but it remains languishing at recent low prices.

China is now the largest producer of gold. It is reported that the Chinese government is not selling any of it, and they have also encouraged their citizens to buy gold and silver for the first time in decades. Other countries such as Russia and India are also buyers of gold. India recently purchased a whopping 200 tons.

Turning back to the Gold Suppression Cartel, there are doubts now emerging about the amount and even the existence of the gold held by central banks. Hong Kong has recently asked for the return of the physical bullion held in London along with similar moves by Arab countries and Germany. Investors are wary of some of the exchange-traded funds that purportedly hold gold and silver, as there are fears that it is not solely metal in their vaults, but paper representing metal that might not exist. Owning gold and silver now is not about a “trade.” We have reached a potentially tectonic moment in the history of the world as one monetary system fades and another emerges—destruction and creation. Taking the right steps could mean the difference between survival and losing everything. We certainly hope that there is no upheaval, but one needs to be positioned now, as there will be no time to react if events get out of control. However, we do not predict that we will reach that state. What is most likely is a secular decline in the value of the dollar. (It has already lost 95% of its real value since 1913, so we expect a continuation of that trend.)

Several major banks are believed to be the implementation tools of the Cartel. Recent statistics suggest that the banks are short 30 million ounces of gold and 300 million ounces of silver. Short means that they have sold something they do not own. If the banks are forced to “cover” those positions, the prices of gold and silver would skyrocket. Up until recently, Barrick Gold has also been a participant in the shorting of gold. The mistake cost them \$6 billion to fix.

In the case of silver, the huge surplus in the days of President Johnson has been mostly consumed in industrial processes. While there is a debate about the amount of gold available in the central bank vaults, there does not seem to be a debate that the amount of silver in reserve is small.

In summary, you have a situation where the world monetary system is unraveling, the supplies of gold and silver are questionable, major institutions are horribly exposed to short-covering on their trading activities at the behest of the central banks, and there is runaway spending on unfunded liabilities. On top of that, Congress seems intent on throwing more fuel on the fire.

We are collectively doing a “Thelma and Louise” as we accelerate toward the cliff, and everyone seems to be trying to press down on the accelerator.

Conclusion... Perhaps Even Cause for Optimism

We have been predicting a global boom: a super cycle. You cannot spend \$20 trillion without having a major economic revival. While the markets are focused on the terrible unemployment rates, the fact is that unemployment always lags recoveries. Perhaps this one might take longer, but a booming global economy will eventually turn the unemployment rate around.

The potential exists for an accident in the short term due to the factors listed above. Absent that, we expect two years or more of a very strong economic environment world wide followed by great uncertainty. If we solve our structural and secular problems, there could be prosperity for decades. If we do not, history is quite clear that the result will be catastrophic for many. Our allocations reflect “insurance” against a collapse of the dollar but will participate nicely in the event of the happy outcome.