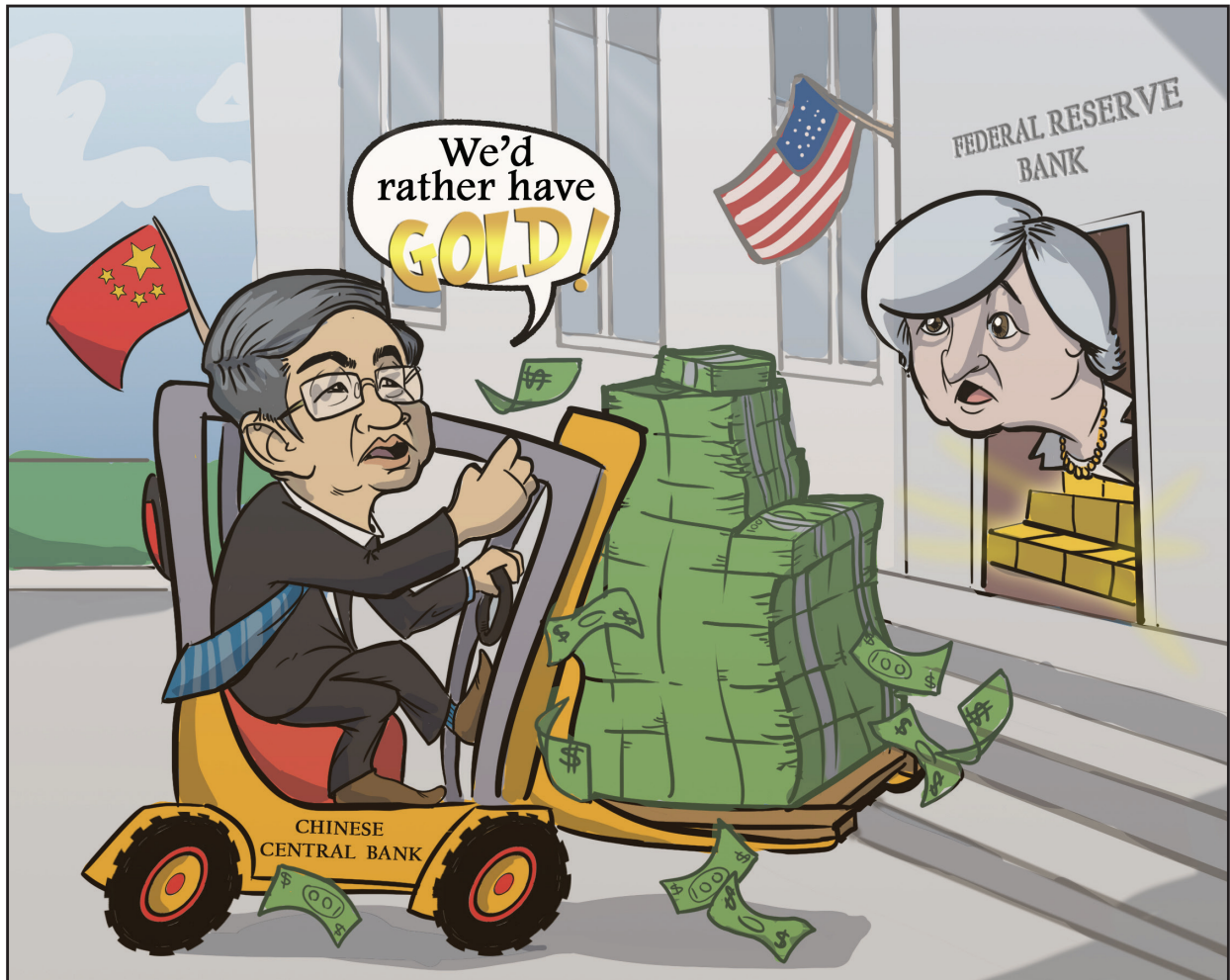


GOLD: REAL MONEY

Your Ultimate Protection
Against Inflation and Deflation



By Barry Stuppler

2014 Update



Barry Stuppler has been a professional numismatist for over 50 years and is well known as an advocate for collectors and investors. He has helped thousands of first-time and experienced coin and precious-metals investors and collectors become successful. Barry is the current chairman of the Federal and California State Gold & Silver Political Action Committee (www.goldandsilverpac.com) and is in constant communication with legislators and lobbyists regarding political events that affect the rare coin and precious metals community.

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1. Introduction

“A lot of money will go poof.”

– *The New York Times*, Nov. 25, 2013

2014 may seem like an odd time to be advising investors of the perils of owning paper assets and the benefits of owning gold. The S&P500 rose 30% in 2013. For the same period, gold declined 28%. (Although gold rose 337% from 2003 through 2013, while the S&P500 increased only 110% for the same period.)

But perhaps this is exactly the time to be issuing such a warning. Think back all those years... to the housing bubble. At the peak of the bubble (2004-2005), home prices in the hottest markets were rising at an annual rate of 25%. As we now know, buyers were bidding up those prices with government-backed loans that they couldn't afford. Wall Street banks were packaging these loans to conceal their underlying weakness and selling them for more than they were worth. It was a market stimulated by money creation (credit) unrelated to real economic facts, such as people's earnings.

“The Great Stimulus”

Washington's response to the Great Recession triggered by the collapse of the housing bubble has been what we might call “The Great Stimulus.” Since 2008, the Federal Reserve Bank has been creating money at an unprecedented rate, primarily by purchasing US Treasury notes. The Fed's balance sheet went from \$1 trillion in December 2008 to \$4 trillion in December 2013. Despite the fact that the recession is supposedly over, the Fed continued to create \$85 billion per month—slightly over a trillion dollars a year—to purchase mortgage debt and Treasuries. On Dec. 18, 2013 the Fed announced a long-awaited “taper.” Beginning January 2014 it will reduce its money creation to \$75 billion per month. \$40 billion will be used to purchase Treasuries and \$35 billion to purchase mortgage bonds.

It might be more accurate to label the Fed's bond-buying spree “The Attempted Great Stimulus.” Economic growth remains sluggish; unemployment and underemployment remain high. (Partly because the Fed is buying debt that previously would have been acquired by China, Japan and other countries in Asia and the Middle

East, while Congress cuts the flow of funds into the general economy through the sequester and other measures.) Incoming Fed Chair Janet Yellen told the Senate Banking Committee Nov. 14, 2013, “It is important not to remove support while the recovery is still fragile.”

Will the Fed's money creation be tempered by prudent management of other major currencies? Hardly. The Bank of Japan is pumping out yen at 60 to 70 trillion a year (US\$596-695 billion)—larger in proportion to their economy than the Fed's assumption of debt. The European Central Bank (ECB) is keeping interest rates at record lows. Its deposit rate (the rate it pays banks who deposit funds with it) is zero, and it is reportedly considering charging banks a negative interest rate of -0.1 percent to pressure them to stimulate the economy by making more loans.

“If It Looks Like a Bubble”

Large financial institutions accused of fraud in connection with mortgage-backed securities have taken advantage of low interest rates to remain liquid enough to make multi-billion-dollar settlements with the government. The US stock market has boomed while the underlying economy flounders. The same is true in Japan. Monetization of debt keeps bond interest rates artificially low, pushing financial institutions, pension funds and individual investors to invest in the stock market. Low interest rates also create an environment that sustains corporate profits despite sluggish sales, seeming to justify investments in stocks. In fact, many large corporations have borrowed money to buy back their stock, creating paper profits for investors without any growth in sales or profits and without investing in future growth through R&D or adding equipment or employees. According to the *Dallas News* (Dec. 30, 2013), “In the trailing 12 months ending in September, 431 companies announced \$448.1 billion in buybacks—the most since 2008... Just in the third quarter, buybacks amounted to \$123.9 billion, a 32 percent increase from the year-ago period.”

Does all this remind you of the housing bubble or, going all the way back...to 2000, the tech bubble? If so, you are not alone. Under the headline, “If It Looks Like a Bubble and Floats Like a Bubble,”

The New York Times (Nov. 25, 2013) wrote,

Back East, the Wall Street money is starting to worry that it feels like 1999 all over again. Money-losing technology companies are going public at you've-got-to-be-joking prices. Twitter is losing money. A price-to-earnings ratio? There is no E in the P/E. But its stock is trading at 20-odd times the company's annual sales. Good enough.

...The founders of Snapchat are getting multibillion-dollar offers—and turning them down. And the NASDAQ composite index, a visible symbol of the '90s dot-com boom and bust, is a sneeze away from 4,000, a level that it last reached before, well, you know. ... Eight months ago, Snapchat was valued at \$70 million. Today, it is valued at \$4 billion, even though it has zero revenue. Six months ago, Pinterest was valued at \$2.5 billion. Today is it valued at \$3.8 billion—and no revenue there, either. ...

"What's likely to happen is that there will be a huge winner-take-all outcome, where one or two companies and investors will be successful," said David Santschi, chief executive at TrimTabs Investment Research in Sausalito, Calif. "But as a result, there will be a lot of companies that are just going to go poof." And a lot of money will go poof with them.

Paper Assets vs. Gold and Silver

For the past three years I have been warning investors that when so much newly created money works its way into the real economy, we are likely to see hyperinflation, and that owning gold and silver is the best protection against that horror. I still believe that hyperinflation is likely, for the reasons outlined in this booklet. Some degree of inflation is a certainty, and in fact is affecting our lives now, government figures to the contrary. If you've been paying for food, gas, entertainment, college, healthcare or travel, for example, you know what I mean.

Ultra-high-net-worth individuals, who got that way by being ahead of the curve, are opting out of paper assets in favor of investables such as fine art, classic cars, high-end rare coins, fine wines, and luxury condos.

Bloomberg News (Nov. 14, 2013) reported:

The perception of investment value helped New York auction houses sell more than \$1.9 billion in two weeks of semi-annual Impressionist, modern, postwar and contemporary art sales.

"Art seems to be a place where many ultra-high-net-worth individuals feel increasingly comfortable parking large amounts of money," said Todd Levin, director of Levin Art Group, who advises collectors. "Money is cheap for them to borrow and they are looking for the strongest returns they can get."

The Mirror (Nov. 17, 2013), a UK newspaper, reports:

This week a basket case Aston Martin DB6 that needed everything made £131,000 at auction, while last month a Ferrari 275 GTB/4 NART Spyder made £17million. Classic cars have become a new asset class, with collectors all over the globe hoovering them up because they know some are increasing in value by 50 per cent a year.

Patrick Heller (*Numismaster.com*, Dec. 3, 2013) writes:

At the same time that record prices are being paid for works of art and other collectibles, trophy rare coins are also selling for record high levels. A 1794 silver dollar sold for more than \$10 million in January, for example. Many other top-quality ultimate rarities also sold for record high prices for the issue. A high percentage of these trophy collectibles are being bought by the extremely wealthy.

The Los Angeles Times (Dec. 8, 2013) reports:

For those with the money to pour in, wine can be a lucrative investment. An index measuring the value of 100 top wines has risen 130% since the end of 2005, double the total return of the Standard & Poor's 500 stock index. Optimists expect the wine market to grow as the wealthy become even wealthier, especially in China and the rest of Asia.

And, according to *The New York Times* (Nov. 13, 2013),

As luxury real estate surges globally, developers with projects in cities around the world are increasingly turning their marketing dollars toward New York.... This is being

helped along by the rising prices in New York's ultraluxury market. Developers selling multimillion-dollar homes have tended to concentrate on the big money in areas such as China, Russia and the Middle East. But as condominium prices in New York approach the \$100 million mark — catching up with cities like London — New Yorkers begin to look like prime candidates.

Few of us can afford to put tens of millions of dollars into any of these investment vehicles. Besides which, they can be illiquid, particularly when you most need liquidity, such as in times of economic turmoil. Physical gold and silver, however, are hard assets with a 24/7 global market. They can be turned into cash virtually anytime, anywhere.

Along with gold, silver should be an important part of your holdings. Right now, financial institutions and corporations are building up their reserves rather than investing in what they see as a shaky economy. Apple alone is sitting on an unprecedented \$145 billion in cash. However, the housing market is strengthening, meaning more money is going into the real economy via mortgage loans. And, ultimately, corporations cannot make money by sitting on it. They'll need to compete by increasing investment in R&D, equipment, labor, and marketing. When the dam breaks and the "velocity of money" increases, the rate of inflation will increase, pushing the price of precious metals higher. Silver will get a double boost, because it's an important industrial commodity as well as an investment vehicle. Silver is used in electronics, chemicals, optics, medicine, clothing (to inhibit growth of bacteria and fungi), automobiles, and many other processes and products.

Investing in gold and silver is critical to retaining and increasing your wealth in the face of inflation, hyper or otherwise. Gold has a centuries-long history of retaining its purchasing power under all economic conditions, even including deflation. Gold is real money. Until 1933 (and internationally until 1971), the US Dollar was backed by gold. Unlike paper assets, or currency supported only by government fiat, gold never goes poof. A retreat in the price of precious metals should be seen for what it is — a buying opportunity. We will show that the intermediate and long-term trend is for gold to continue its upward march toward \$5,000 oz or more. Readers of my 2011, 2012, and

2013 booklets will recognize some of the historical material. History doesn't change.

The Emergence of China

But, history continues to be made. And the major historic change of the late 20th and early 21st century is the emergence of China as a political, economic, and military superpower. That change is occurring simultaneously with the decline of the US Dollar as the unquestioned global reserve currency, which we trace in this booklet.

As we also describe, the Chinese government is determined to accelerate the USD's decline and raise their currency, the renminbi (AKA, the yuan), to reserve currency status. To accomplish that, they see the need (among other things) to support the renminbi by raising the level of gold reserves in their central bank. Accordingly, they have surpassed South Africa, Russia, the United States and Australia to become by far the world's largest producer of gold, and they have surpassed India in 2013 to become the world's largest importer of gold. China has also passed laws and adopted practices that enable its citizens to invest in gold, putting hundreds of millions of new buyers into the gold market. This development, along with others that we will discuss, will strengthen demand for gold for years to come...at a time when global production is falling, despite the growth in Chinese production. You no doubt recall from Eco 101 what happens when demand rises and supply shrinks.

It's Up to You

In this booklet I lay out the case for owning gold and silver. There is some urgency involved. We don't know when the current relatively low prices of precious metals will end, and we don't know when the bubble in paper assets will pop. If after you read this booklet, you have questions about whether to start owning gold, or add to your gold holdings, or how to go about it, I'd be happy to try to answer them. After that, it's up to you. Many people saw that the tech and housing bubbles had to burst, and felt that they should change their investments accordingly, but couldn't quite make the move until it was too late. It's hard to head for the lifeboats when almost everyone else is yelling, "Don't be left out. Stay on board. The party goes on!" I hope that the information in this booklet helps give you the strength and courage to protect yourself and your family in the difficult times that lie ahead.

2. The Price of Gold: Past, Present, Future

Before we risk getting lost in the details, let's look at the big picture. In 1933, when gold was pegged by the US government at \$35 per oz., a first-class postage stamp cost three cents. Today, a first-class postage stamp costs 46 cents, an increase of 1,433%. Even after its fall from the \$1900 area, gold closed 2013 at \$1,205 per oz., an increase of 3,345% from 1933. We could make many similar comparisons. In 1933, milk cost an average of 16 cents a quart. Today it can be anywhere from \$1 to \$2 or more a quart (cheaper if you buy gallons). Even if we say \$2, milk is up "only" 1,150% from 1933—way below gold's price increase. The average price of a new car in 1933 was \$800. Today it's over \$31,000, an increase of 3,775%. That's a little more than the increase in gold's price, but an ounce of gold is still an ounce of gold. It hasn't added power steering, power brakes, automatic transmission, steel belted radials, seat belts and air bags, satellite navigation, entertainment systems, and greatly increased speed and reliability. Clearly, over the past 80 years, owning gold preserved value—with minimal risk. Gold can't go bankrupt and, unlike other hard assets, it's always liquid.

Gold Is Gold. Is the Dow the Dow?

You'll often hear about the stellar long-term performance of the Dow Jones Industrial Average. But unlike gold, "the Dow" is ever changing, like the automobile. Only 4 of the 30 companies in the Dow Jones Industrial Average in 1933 remain in the index today: Coke, GE, IBM, and Proctor & Gamble. Three others are still in as a result of mergers. Eight have gone through bankruptcy. All eight, along with 15 other companies, were removed from the Dow and replaced by better performing companies. For example, Woolworth was replaced by Wal-Mart in 1991; Johns Manville was replaced by American Express in 1982. If you constantly shed bankrupt and poorly performing companies and replace them with growing, profitable companies, often from completely different sectors of the economy, it's not hard to create an index that performs well—on paper.

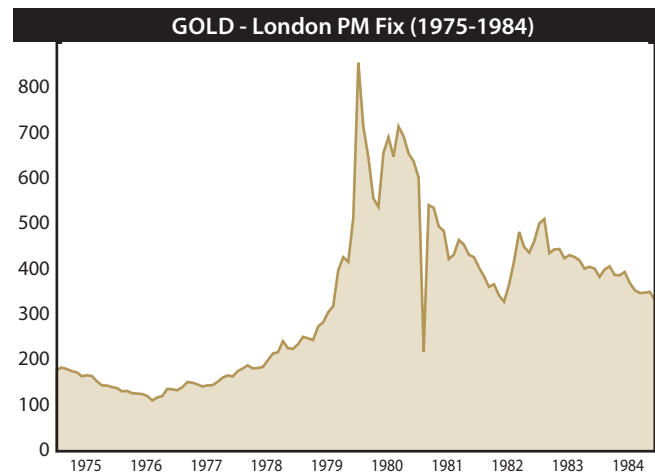
When I wrote *Gold: \$2011 by 2011* in 2008 (when gold averaged \$850 oz.), I felt that gold would surge by late 2010-early 2011, and that we would reach \$2,011 by the third quarter of 2011, followed by a dramatic correction before further advances.

In fact, spot gold did reach a record high in Q3 2011—an intraday high of \$1920.80 on Sep. 6. But rather than going on to \$2011 and beyond, the "dramatic correction" began.

What I had not fully foreseen in 2008 were the financial bailouts of 2008, 2009, and 2010, continuing high unemployment, and home prices that continued to decline far longer than economists expected.

Gold bull markets typically have three phases.

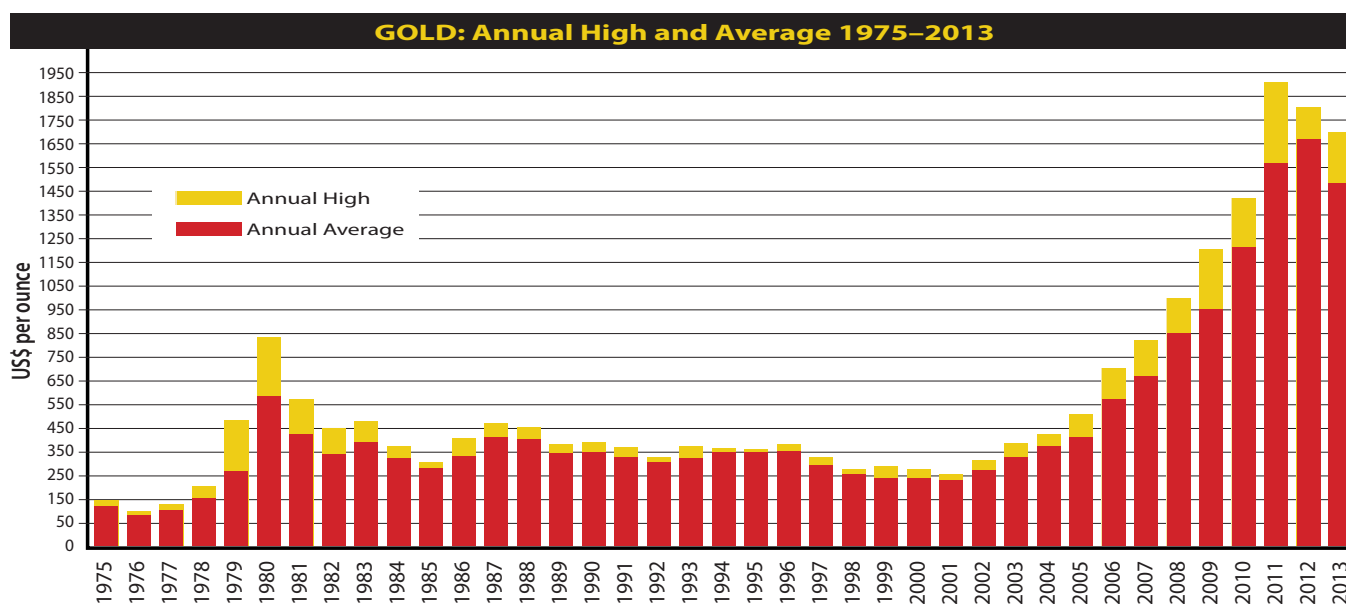
The chart below shows the previous bull market in gold. As you can see, there is a period of gradual increase from early 1977 to July 1979 (Phase I), followed by a period of accelerating increase from July 1979 to the end of 1979 (Phase II), followed by a near-vertical ascent in January 1980 (Phase III). The table on the next page summarizes these phases.



Gold price increases from 1977 to 1980 (the previous all-time high)

Phase I		
Date	Price	Change/Time
January 1, 1977	\$134.50	
January 1, 1978	\$169.20	+25.79% in a year
January 1, 1979	\$226.00	+33.56% in a year
July 1, 1979	\$277.50	+22.78% in six months (45.56% annualized)
Phase II		
January 1, 1980	\$512.00	+84.50% in six months (169% annualized)
Phase III		
January 21, 1980	\$850.00	+66.01% in 20 days (1,204% annualized)

The chart and table below show that this century's run-up in the price of gold has been more prolonged (2001–2012 so far) and more gradual.

**Gold price increases from 2001 to 2013**

Phase I		
Year	Closing Price	Change
2001	\$276.50	
2002	\$348.10	+25.90%
2003	\$415.70	+19.42%
2004	\$437.50	+5.24%
2005	\$517.10	+18.19%
2006	\$638.00	+23.38%
2007	\$833.20	+30.60%
2008	\$878.30	+5.41%
2009	\$1,096.50	+24.84%
2010	\$1,422.00	+29.68%
2011	\$1,566.80	+10.20%
2012	\$1,675.80	+6.95%
2013	\$1,204.50	-28.12%
Average annual increase		13.20%

It appeared in the summer of 2011 that Phase II of the current gold bull market had begun. On the last trading day of June, gold was at \$1,506. On the last trading day of August, it had risen to \$1,825—an increase of 21.18% in two months, annualized to 127.09%. Intraday gold rose above \$1,900 several times in August and September. This was especially remarkable because May through August is usually the period when gold is flat or declines in price. Mid-September through December is typically the boom time for gold, driven by Asian jewelry buying.

With the power of hindsight, we can see that the flare-up in summer 2011, while a hint of things to come, was not the beginning of Phase II. It was a reaction to the near failure by Congress to raise the federal debt limit and the accompanying lowering of the US national debt rating by Standard & Poors. When strong buying of Treasuries continued

despite the downgrade, the steep rise in the price of gold leveled out and then began its correction.

The extraordinary length of this century's Phase I has built a powerful base for Phases II and III. Many developments, some impossible to foresee, could affect the timing. I think it more likely that Phases II and III will occur within the next five years than further into the future. I foresee gold reaching a minimum of \$6,000 per oz. in Phase III.

Bourgeoning Chinese Demand Revolutionizes the Gold Market

The People's Bank of China, the central bank, has been hinting that it is purchasing [gold]. "No asset is safe now," said the PBOC's Zhang Jianhua at the end of last month. The only choice to hedge risks is to hold hard currency – gold." – Forbes, January 29, 2012, "Why Are the Chinese Buying Record Quantities of Gold?"

In 2013, China surpassed India as the world's number-one consumer of gold. This is a historic, market-changing event. (See foldout following page 20.) Whereas Indian families have been buying gold for centuries, as we'll discuss later, it was illegal for Chinese people to buy gold after the communist revolution of 1949. China has come roaring into the gold market only since the 1980s, when restrictions against citizens owning gold were loosened. The final restrictions were eliminated in 2001. In that year, Chinese demand for gold jewelry, bars, and coins was 200 tonnes.¹ In the first three quarters of 2013, according to the World Gold Council, Chinese consumers' demand for the same items was already 518 tonnes, which projects to an annual 691 tonnes.

Chinese demand for gold comes from the central bank and from the increasing segment of the Chinese population that has money to invest. At over 300 million, that segment is already larger than the entire US adult population. Furthermore, in China (and throughout Asia), gold is virtually universally viewed as a store of family wealth and as protection against inflation. Even gold jewelry is considered more as investment than ornament.

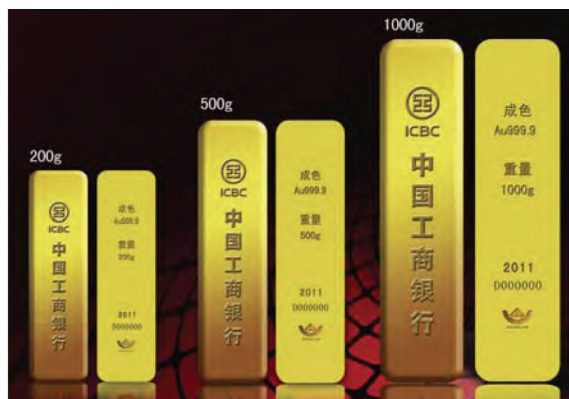
A growing number of Chinese people—already more than 4.5 million—purchase gold through a monthly accumulation program at the Industrial

and Commercial Bank of China (ICBC). Regardless of the price, they buy a set amount of gold each month for a renewable period of 1–3 years (thus averaging out market moves) and the bank stores their metal. At the end of the contract period, participants take delivery in gold or cash, or continue to store the gold at the bank. The bank estimates that by 2015 millions more will subscribe to the program. These people are not buying mining shares or gold futures or shares in a gold ETF or any other paper derivative. They are a steady—and growing—source of demand for physical gold.

To grasp the power and potential of this program, realize that ICBC is the largest bank in the world, with assets of US\$2.95 trillion and 380,000 employees. Seven thousand of its branches offer gold trading service, and 3,000 of them stock gold bars for immediate sale. In addition, the bank has opened "Gold Elite VIP Services Centres" which serve as "'flagships' for the promotion of gold investment products in major cities."² The first center opened in Shanghai in 2010; there are now 100.



ICBC World Headquarters in Beijing.

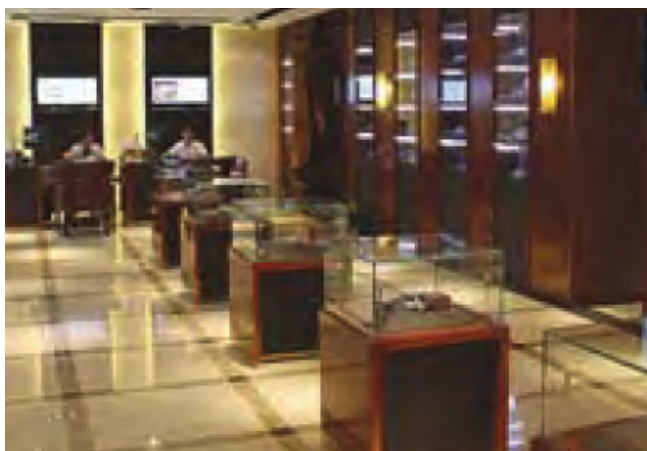


The main range of ICBC's small investment bars, from 20 to 1,000 grams.³

1 Large quantities of gold are measured in tonnes. Unlike the US ton (2,000 lbs.), a tonne, or "metric ton," is equal to 1,000 kilograms, or 2,204.62 lbs.

2 www.icbc.com.cn, click on precious metal.

3 A gram weighs about as much as a small paper clip. 28.35 grams = 1 avoirdupois ounce. 1,000 grams (1 kilogram) = 2.2046 lbs.



A Gold Elite VIP Services Centre

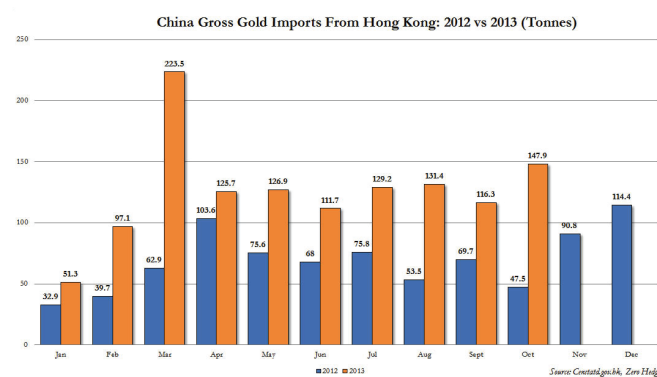
Chinese Government's Increasing Demand for Gold

We've talked about why Chinese citizens are accumulating gold. This cable from the US embassy in China to the State Department, released by Wikileaks, explains why the Chinese government is also increasing its gold holdings:

The China Radio International sponsored newspaper World News Journal (Shijie Xinwenbao) (04/28[2011]): 'According to China's National Foreign Exchanges Administration, China's gold reserves have recently increased.... The US and Europe have always suppressed the rising price of gold. They intend to weaken gold's function as an international reserve currency. They don't want to see other countries turning to gold reserves instead of the US dollar or euro. Therefore, suppressing the price of gold is very beneficial for the US in maintaining the US dollar's role as the international reserve currency. China's increased gold reserves will thus act as a model and lead other countries towards reserving more gold. Large gold reserves are also beneficial in promoting the internationalization of the RMB [renminbi].'

Evidence suggests that the People's Bank of China (PBOC) is underreporting its gold holdings, among other reasons to hold the price down, enabling it to accumulate gold more cheaply. First, although China has boosted its gold production to a world-leading 400+ tonnes per year, there is no sign that any of that locally mined gold is leaving China or even entering its domestic market. Gold refiners, fabricators, and traders outside China report never seeing gold bars with Chinese stamps on them. Many observers believe that the gold is going

straight into the PBOC. Secondly, China has been steadily increasing its imports of gold, through Hong Kong. An article by Tyler Durden (Dec. 8, 2013) on *zerohedge.com* points out that Chinese imports of gold from Hong Kong have been higher every month of 2013 than the same month in 2012 (January through October, the latest month for which the data has been reported). This is true on a gross and net (subtracting exports) basis. Durden summarizes the data in the chart below this way: "China's gross YTD [through October 2013] imports now amount to just over 1260 tons, while the net gold imports from Hong Kong are a record [even for an entire year] 982 tons."



Durden concludes,

China has imported a whopping 2380 tons of gold in the past 26 months. Throughout this period the PBOC has never updated its new official holdings number. However, one thing is clear: the more the price of (paper?) gold drops, the more the Chinese purchases of physical gold become. And yes, that is 26 consecutive months of positive (and increasing) gold imports.

Juggling the figures, it appears to many observers that China's central bank now holds at least 4,000 tonnes of gold, putting it ahead of Germany and behind only the United States (assuming the US actually holds the gold it claims to hold, which we'll discuss below).

Bottom line: More and more people in China are accumulating more and more physical gold, and the People's Bank of China is accumulating gold. Even if the PBOC now holds 4,000 tonnes, that gold would amount to only 4% of the value of all of China's \$3.66 trillion in foreign reserves. By contrast, Germany's gold constitutes 69.8% of its foreign reserves; Italy's, 68.4%, and France's,

67.6%. China's ambition to elevate the status of the renminbi clearly requires the PBOC to continue its purchases of physical gold well into the future.



China Tunnels for Gold in New York City

In October 2013, Fosun International Ltd., a Chinese company, bought 1 Chase Manhattan Plaza from JPMorgan Chase & Co. (JPM) for \$725 million (www.bloomberg.com, Oct 19, 2013). 1 Chase Manhattan Plaza is a 60-story office building that was the headquarters of Chase Manhattan Bank when it was led by David Rockefeller and became headquarters of JPM via the Morgan-Chase merger. Five floors below street level, on the granite bedrock of the island of Manhattan, the building houses the largest gold vault in the world, the size of a football field. Directly across Liberty Street sits The Federal Reserve Bank of New York. That, not Fort Knox, is where the largest portion of US gold reserves are stored. The NY Fed's vault is also five stories below the surface, on bedrock. And it is connected to the JPM vault by a tunnel. To take delivery of US gold from the Fed, the Chinese won't even need the forklift in our cover illustration.

Increasing Central Bank Gold Purchases

The emergence of China as the world's number-one producer and importer of gold is certainly the primary driver of today's gold market (along with the massive monetization of sovereign debt that is making gold so attractive to the Chinese). However, several other important trends will contribute to increasing the price of gold. One is a recent reversal by central banks.

Until 2010, the world's central banks were net sellers of gold. The sales were almost entirely from European central banks. In 1999, to prevent sales from unduly diminishing the value of their gold,

the European central banks came to a voluntary agreement to limit their sales to 400 tonnes a year for five years. Called the "Washington Agreement on Gold" because it took place at an IMF meeting in Washington, DC, the agreement was extended for five years in 2004 and again in 2009.

As faith in the dollar, euro, pound, yen and other fiat currencies diminished, European central banks cut back on or completely halted gold sales and did not reach their quotas under the Agreement. For example, in 2012 the only sale recorded by any European central bank was 4.2 tonnes by Germany, for the minting of coins.

Simultaneously with European central bank sales drying up, central banks in emerging countries started buying gold to strengthen their reserves. 2010 was the first year in decades that central banks were net purchasers of gold. As the table shows, 2011 saw a sharp increase in purchases, and 2012 continued the upward trend. If Chinese central bank purchases of an estimated 400-500 tonnes were included, 2013 would show an enormous increase rather than a decrease.

Central Bank Gold Purchases (not including China)

Year	Purchases (tonnes)
2010	77.3
2011	456.8
2012	534
2013	396 (estimate)

Source: World Gold Council

Central banks in developing economies will almost certainly continue to buy gold, because their confidence in the USD, euro and yen continues to erode and because their holdings as a percentage of total reserves are tiny relative to the US and Europe. According to official central bank reporting, the US holds 72% of its reserves in gold; Germany, 69%; France, 66%. Even the UK, which infamously sold much of its gold at bargain basement prices from 1999 to 2002, is at 13%. By contrast, Chinese gold reserves (when last reported) are 1.2%; India's 8%; Argentina's 8%; Russia's 8%; Mexico's 3%; Indonesia's 4%; South Korea's 1%; and Brazil's 1.0% .

Central banks that purchased gold in 2013 included those of China, Russia, Mexico, Turkey, Kazakhstan, South Korea, Ukraine and Azerbaijan.

Central Bank Repatriation of Gold

The Bundesbank, Germany's central bank, announced January 16, 2013, that it was going to bring a portion of its gold stored abroad back to its vaults in Frankfurt. All 374 tonnes of German gold stored at the Banque de France will be repatriated, along with 300 tonnes (out of about 1,500) stored at the Federal Reserve Bank in New York City. For unexplained reasons, the transfer from New York will be spaced out over seven years.

– *The New York Times, Jan. 16, 2013*

During the Cold War, when West Germany was concerned about the possibility of a Soviet invasion, the country moved a great deal of its gold to London, Paris, and New York. From another point of view, holding Germany's gold was one of a number of ways the victorious allies kept tight control on post-World War II West Germany.

In January, 2013, the Bundesbank (or Deutsche Bundesbank, to use its full name) said that it made sense to keep some of its gold in the US and the UK, because in the event of a currency crisis it could quickly use it to buy dollars or pounds, but that with France and Germany both on the euro, there was no similar need to keep gold in Paris.

Despite the Bundesbank's efforts to downplay the significance of its move, many analysts see deeper motives, including the following:

- Increasing mistrust among the world's central banks, as trade wars and currency wars intensify.
- Decreasing confidence that the USD will maintain its position as the global reserve currency.
- Recognition that the gold standard is making a de facto comeback. (See the change of gold to a Tier 1 asset in the section below.)
- Growing German displeasure with France pushing Germany to fund bailouts of failing governments and banks in the southern tier of the Eurozone, along with strengthening ties between Germany and Russia.

There has been speculation about why it will take seven years to move 300 tonnes of gold from New York to Frankfurt. The speculation centers around the idea that much of the US gold reserve, officially

reported as 8,133 tonnes, has been leased out, is unavailable until replaced, and that replacing 300 tonnes at once would drive up the price of gold. A variation on that theme is that the Fed leased out the German gold with the agreement of Germany.

"Gold leasing?" you might ask. Central banks loan gold to "bullion banks," such as Goldman Sachs and Barclays, for a given period of time. The interest rate for a 1-year loan, as of Dec. 13, 2013, was 0.4263%. The bullion bank sells the gold (for example to jewelry manufacturers) and invests the cash in securities that pay a higher rate of interest. At the end of the period of the loan, the bullion bank must return an equal amount of gold to the central bank. To buy the gold, the bullion banks sell their securities. The bullion bank may hedge all or some of its risk by buying futures contracts for the delivery of gold at a particular price on a particular date. As soon as the gold is paid back, another lease may be issued. In other words, the loans are rolled over, so in essence the gold stays out on the market.

When this process goes smoothly, the central bank makes a small return, the bullion bank makes a little larger return, and the price of gold is suppressed by putting gold reserves into the market. However, there is risk involved. Bullion banks were tempted to avoid the expense of hedging in the futures market—a disastrous course when the price of gold is rising. And with the interest rate on Treasuries so low, they were tempted to invest the cash in more volatile securities. Leased gold shows up on a central bank's balance sheet whether it has been repaid or not. And the process is opaque, so no one outside the central bank/bullion bank collaboration knows how much physical gold has disappeared from central bank vaults.

Germany is not alone in repatriating gold. In January 2012, Venezuela completed the transfer of 160 tonnes of gold to Caracas from Europe, the United States, and Canada, as "a safeguard against instability in financial markets." (*Bloomberg News*, Jan. 30, 2012) In January 2013, the State Oil Fund of Azerbaijan announced that it was moving its gold from the London vaults of bullion bank JP Morgan to the central bank in Baku.⁴

Along with increasing purchases of gold by central banks, the move toward repatriation of gold

⁴ <http://abc.az/eng/news/main/70838.html>

recognizes—and accelerates—the devaluation of all fiat currencies.

Commercial Banks Increase Gold Purchases

The Basel III Framework, which went into effect January 1, 2013, moved gold from a Tier 3 asset to a Tier 1 asset. What does that mean?

Short version: commercial banks will buy and hold more gold.

Longer version: In 1974, the central bank governors of the Group of Ten (the 10 countries with the world's major economies at that time) established the Basel Committee on Banking Supervision (BCBS). The BCBS (so named because it meets in Basel, Switzerland) issues “frameworks” to standardize supervision of commercial banks. The standards are in turn enforced by each nation's central bank.

“Basel III,” as the new framework is known, covers 2013 through 2017. Basel I and Basel II, which governed commercial bank practices from 1989 through 2012, classified gold held by a bank as a Tier 3 asset. As a Tier 3 asset, only 50% of the value of gold could be counted toward reserves against outstanding loans. Basel III reclassifies gold as a Tier 1 asset, along with cash and bonds. As such, 100% of its value counts toward required reserves. In essence, the new framework says that gold is the equivalent of money. Basel III also raises the amount of Tier 1 capital a bank must hold from 4% of risk-weighted assets to 6%—a 50% increase! Thus, as we said, “Commercial banks will buy more gold.”

As if to prove our point, JP Morgan Chase Bank took physical delivery (as opposed to speculating on futures contracts) of 315,100 oz. of gold in August 2013 and another 442,600 oz. in December (as of Dec. 15). That's a total of 23,567 tonnes of gold. This gold was purchased for the bank's house account, not for customers.

Physical Gold Getting Scarce

Such massive commercial bank purchases have pushed down gold reserves on the COMEX to record lows. COMEX used to be known as the Commodity Exchange. It merged with the New York Mercantile Exchange (NYMEX) in 1994, which in turn was taken over by CME Group in 2008. CME also owns the Chicago Mercantile Exchange and the Chicago Board of Trade.

COMEX, the metals trading division of NYMEX, is the world's primary market for trading future contracts in precious metals (gold, silver, platinum, palladium) and copper and aluminum. A futures contract obligates its owner to buy or sell a given amount of gold at a given price on a given date.

COMEX must store gold in its vaults to be prepared to deliver gold on the delivery dates of futures contracts. When long (agreeing to take delivery) and short (agreeing to make delivery) positions are more or less in balance, COMEX easily maintains its stores of gold. But when there are far more long than short positions, COMEX can run low. (Some gold stored by its owners at COMEX is not for sale. We're talking here about “registered” gold, which is for sale.) In early 2011 registered COMEX gold reached over 10 million oz. In Nov. 2013 it was in the 6.5 million oz. range, near its all-time low.

According to the World Gold Council, the world's gold mines produced 2,862.5 tonnes of gold in the 12 months ending Sep. 30, 2013. Global demand for that period was 4,476.9 tonnes. Some of that gap was covered by sales of gold by ETFs, as investors withdrew funds. Gold held by ETFs decreased from 1,328 tonnes in January 2013 to 906 tonnes in September, adding 422 tonnes to the supply. (ETF gold inventories dropped further, to 828 tonnes by the end of 2013.) The gap between mine supply and demand is far too large to be made up by ETF withdrawals, scrap, or gold sales by individuals. Besides, at some point, net inflow into gold ETFs will resume, adding to gold demand rather than supply.

Backwardation

When physical gold is in short supply and holders of physical gold are reluctant to sell, “backwardation” can occur. Backwardation refers to a condition in which the price of physical gold for immediate delivery (the “spot price”) is higher than a future price, or when the gold price for a contract that expires in a near month is higher than that of a contract that expires later. As we have said, precious metals are highly liquid. Therefore, backwardation is rare, because a trader could make easy money by selling the metal at the spot price and buying a contract for future delivery at a lower price.

On the rare occasions when it does occur,

backwardation in precious metals typically lasts only a day. However, in the summer of 2013, gold backwardation persisted for 40 consecutive trading days. What does this mean? The consensus among those who study the gold market is that it represents a fear that future physical delivery might be jeopardized by short supply.

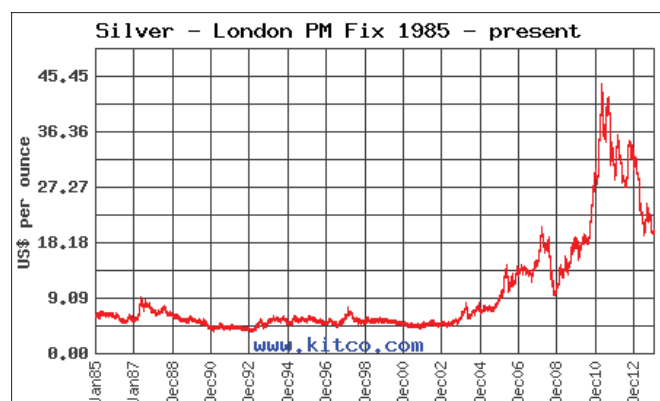
In this instance, the trigger was fear of a short squeeze. Gold had fallen sharply in June, leading

many traders to sell short, expecting further declines. But gold rose during July and August, leading short sellers to rush to buy gold to cover their positions and avoid further losses. That put a premium on physical gold.

For now, let's just remind ourselves that price fluctuations relate to supply and demand, and that diminishing stocks of gold reveal rising demand for physical gold.

3. The Role of Silver

The price of silver has a general tendency to correlate with the price of gold. The same month that gold hit its previous all-time high of \$852, in January 1980, silver streaked to a peak of \$50.50 per oz. It quickly dropped back into the single digits, where it lingered for many years. In 2003, silver entered its current bull market, reaching a high of \$49.84 in April 2011. Unlike gold, silver has yet to surpass its 1980 high. Much of the reason for that is that the 1980 price was boosted by the Hunt brothers' attempt to corner the silver market through huge margin purchases.



Like gold, silver is an investment vehicle. Unlike gold, a significant part of the demand for silver is industrial. Therefore, while the two precious

metals tend to rise and fall together, they are by no means in lockstep. In December 2013, the ratio of the gold price to the silver price was in the area of 60 to 1. Since 1940, that ratio has been as high as 94 to 1 and as low as 22 to 1. Such fluctuation creates investment opportunities through shifting the proportions of your precious metals holdings—by selling gold and buying silver or vice versa. Or, if you are continuously adding to your precious metals holdings, by buying more gold or more silver as the gold/silver ratio fluctuates.

In *The Australian* magazine (July 15, 2011) Robin Bromby reports that silver demand is expected to climb dramatically as demand from healthcare, clean energy and water purification increases. New technologies like crystalline silicon solar cells, radio frequency identification tags, and biocides (agents that destroy harmful organisms) plus bacteria removal in new water purification systems are expected to increase silver demand by 6,600 metric tons in the next nine years. *Thomson Reuters* (Nov. 13, 2013) notes, "Jewelry demand [for silver] has been particularly strong amongst emerging countries with demand surging in India as consumers switch away from gold due to draconian government regulations put in place this year in order to curb gold imports."

4. Inflation: Don't Worry, Be Happy

To justify keeping short-term interest rates at or close to zero, the Fed has been assuring us that inflation is not a problem. They support this claim by citing the Consumer Price Index (CPI). For example, according to the Bureau of Labor Statistics (BLS), the CPI (average annual expenditure for all items in the index) rose only 1.8% in the 12 months ending November 2012 and only another 1.2% in

the 12 months ending November 2013.⁵

The BLS uses complicated social assumptions and mathematical calculations to arrive at the CPI. These assumptions and calculations have changed over time. According to Shadow Government Statistics (www.shadowstats.com), if the CPI were

⁵ www.bls.gov

calculated today as it was in 1990, inflation would be running at about 4.5% rather than 1.2%. If the CPI were calculated as it was in 1980, inflation would be running at about 8.5%.

When our friends and family members talk about what they actually spend money on—food, gasoline, medical care/medical insurance, utilities, college tuition, car maintenance, parking, entertainment, air travel—their experience seems more in accord with the Shadow CPI than with the official CPI. True, some prices have come down or held steady as a result of retailers desperate to bring people into their stores. And most new and existing homes still sell for below the prices they went for during the housing bubble, although rents in most areas are up.

What is undeniable is the run up in most commodity prices over the past 10 years. Just look at this table of selected commodities and the entire commodities index.⁶

Commodity	Nov. 2003	Nov. 2013	Change
Gold	389.91	1,275.86	227.2%
Silver	5.21	20.76	298.5%
Copper	2,053.28	7,070.65	244.4%
Iron ore	13.82	136.32	886.4%
Aluminum	1,511.60	1,747.96	15.6%
Tin	5,363.35	22,826.88	325.6%
Oil	29.12	102.58	252.3%
Coal	32.05	88.13	175%
Wheat	160.55	306.75	91.1%
Sugar	0.21	0.22	4.8%
Soy Beans	279.74	476.66	70.4%
Coffee	0.36	0.86	139%
Pork	0.49	0.82	67.3%
Beef	1.11	1.83	64.9%
Salmon	2.96	6.41	116.6%
Cotton	0.77	0.85	10.4%
Commodities Index	67.00	181.00	170%

Source: Index Mundi (www.indexmundi.com) Units described in footnote.

⁶ All prices wholesale, in USD, rounded off to nearest dollar except when cents are statistically significant. Units: gold and silver per oz; base metals and coal (Australian thermal) per metric ton; oil per barrel, simple average of Dated Brent, West Texas Intermediate, and the Dubai Fateh; wheat per metric ton; sugar, US import price, per pound; soy beans per metric ton; coffee, robusta, per pound; pork, beef, salmon cotton per pound. Commodity price index includes all 100 commodities.

The overall index, composed of 100 commodities, is up 170% in 10 years. That corresponds to a compound annual interest rate of 10.45%—even higher than the CPI calculated by the 1980 formula. Yet the CPI for the same 10-year period rose from 184.5 to 233.069—an increase of only 26.3%. That corresponds to a compound annual rate of 2.37%.

We are often told that these increases in commodity prices have not been or will not be passed on to consumers. It is inconceivable that increases of this magnitude would not be reflected in retail prices, unless manufacturers and/or retailers are content to accept enormous losses over long periods, or have increased productivity by impossible amounts. Therefore, we have all the more reason to look with skepticism at the official CPI, and to believe that those who encourage inflationary policies seek to conceal the extent of existing inflation.

Does it matter? Higher rates of inflation do not spring from outer space. They are born out of current policy. Those in a position to influence the economy—the Administration, the Congress, and the Fed—either oppose inflation or abet it. By pretending that price inflation is lower than it is, they reveal clearly which path they have chosen.

Loss of Confidence in the USD

The US Dollar Index measures the value of the dollar relative to a weighted basket of six other currencies: the euro, Japanese yen, British pound, Canadian dollar, Swedish krona, and Swiss franc. The formula was set at the start of the Index, in March 1973, to give the US dollar a value of 100.

On this Index, the USD has reached as high as the 160s. It dropped below 100 in 2003 but always managed to stay above 80. Currency traders, economists, and others considered 80 to be a “floor” supporting the dollar. In late August 2007, the dollar fell below 80 for the first time, hitting a record low of 71.56 in April 2008. At 80 the dollar had dropped to less than half of its highest value.

UNITED STATES DOLLAR INDEX (January 1980–April 2013)



Source: tradingeconomics.com

Since 2008, the US Dollar Index has bounced back as high as 88. It fell rapidly beginning in June 2010 and dipped below 74 in May 2011. In 2012, the dollar rebounded to a high of 84 but began falling in July and closed the year at 79.67. A year later, it was almost unchanged at 80.36. The Index underestimates the fall in the dollar's value, because the comparison is to other fiat currencies that have also been falling relative to purchasing power and to gold. The basket of six currencies in the Index is weighted, with the euro alone accounting for 57.6% of the total. Confidence in the euro has fallen with debt crises requiring bailouts in Greece, Ireland, Portugal, and Spain, as well as high levels of anxiety about Italy's sovereign debt and fears that the EU will not be able to solve its north-south divisions.

Relative to gold, the dollar has fallen 93% since March 1973, when the US Dollar Index was initiated. \$14 will buy the same quantity of gold as \$1 bought in 1973.

Chinese Promotion of Their Currency over the US Dollar

The post World War II Bretton Woods Agreement⁷ enshrined the USD as the global reserve currency. For decades, virtually all major international finance (loans, corporate takeovers, purchases of mineral rights, lines of credit) and most international trade was conducted in USD. That required buyers to convert their currencies to USD to import goods made anywhere. And it meant that countries that were net exporters ended up accumulating USD. Oil, for example, was sold in "petrodollars," so Middle Eastern oil exporters ended up with huge USD holdings. Japan, South Korea, Taiwan, and,

⁷ An agreement regulating the post-WWII international monetary system reached by representatives of 44 nations meeting in Bretton Woods, New Hampshire in 1944.

most recently, China were also awash in USD as a result of exporting manufactured goods to the US and the rest of the world.

Having the reserve currency gives the US an advantage in finance and trade. Typically, countries with large holdings of USD invest in securities issued by the US Treasury and other US agencies, thus supporting the US economy. According to the US Treasury (www.treasury.gov), China held about \$1.294 trillion in US Treasury debt as of September 2013. They also hold about \$400 billion in mortgage bonds from FannieMae and FreddieMac. The Chinese are not transparent about their foreign reserves, but it's estimated that about 60% of their \$3.66 trillion is in USD-denominated securities, with most of the rest in Japanese yen and euros.

Chinese leaders, along with many other major players in international finance and trade, are no longer content to allow the USD to dominate world finance and trade, for many reasons:

- Since 1971, the USD has not been backed by gold or any other hard asset.
- Since 2008, the Fed has been creating USD at an unprecedented rate, essentially devaluing the dollar relative to other currencies.
- Because the Fed has been suppressing interest rates, US Treasuries pay a low or even negative real interest rate (rate of interest minus rate of inflation).
- When the USD was made the global reserve currency, the economies of every other major power in the world had been destroyed by war. Now, the EU has the largest GDP in the world (\$16.7 trillion compared to the US's \$15.7 trillion) and China has passed everyone else, at \$8.2 trillion and climbing. (Figures from the World Bank for 2012).
- While the US still has the largest and best-equipped military in the world, since 1970 its record has been mainly losses and stalemates, most notably Vietnam, Iraq, and Afghanistan. The Chinese feel that the US can no longer impose its will on the world through military predominance.

China has been pushing for a basket of currencies to replace the dollar as the global reserve currency.

The International Monetary Fund first suggested this in 2011, using already existing Special Drawing Rights (SDRs), which are composed of the USD, the Japanese yen, the euro, and the British pound. The Chinese would like to see the renminbi eventually added to the mix. To make the renminbi (also known as the yuan) more viable as a reserve currency, the PBOC is adding to its gold reserves, as we have already described. In addition, China has made or is negotiating numerous bilateral trade agreements that enable direct payment in renminbi and the partner's currency, bypassing the need for USD conversion. They have made such agreements with the European Central Bank, Russia, Japan, Australia, Iran, the United Arab Emirates, Venezuela, Brazil, Peru, and a number of African countries, including Sudan. This is part

of a general trend that includes some oil exporters accepting payment in euros, gold, renminbi and rubles.

The renminbi was involved in only 2.2% of international trade in 2013, compared to 87% for the USD (the total is 200%, because two currencies are involved in each transaction). However, always watch for the new and emerging trend, particularly when it is accelerating. In 2001, the renminbi was at 0%, in 2007 at 0.5%, in 2010 at 0.9%, and in 2013 at 2.2%.⁸

As the USD slips from its perch as the sole global reserve currency, its purchasing power will decline further. The price of goods in the US – particularly imported goods – will rise.

5. Steps on the Inflationary Path

Today the US debt is \$16.7 trillion. The entire Gross Domestic Product of the US is \$15.68 trillion. This means that the debt to GDP ratio is over 105%. History shows that a debt to GDP ratio of over 100% is dangerous. With the debt now growing exponentially, we face a situation of inflation, hyperinflation or bankruptcy

– Richard Russell, *Dow Theory Letters*, Dec. 16, 2013

We've talked about commodity inflation, loss of confidence in the US Dollar, and changes in calculating the CPI that conceal the actual rate of inflation. Here we will trace other key events and trends that have put the United States onto an inflationary path. They include

- The transition to fiat currency
- Mushrooming federal budget deficit
- Monetizing federal debt
- Growing trade deficits
- Increase in money supply
- Social turmoil
- Global instability

First Step Toward Fiat Currency

In June 1933, the United States House and Senate, acting jointly, passed House Joint Resolution 192. In response to the "existing emergency" (The Great Depression), the resolution terminated the right of people, corporations, and governments in the US to demand payment of financial obligations in gold. Instead, US dollars, no longer backed by

gold, were to be accepted as "legal tender for all debts, public and private."



Prior to that resolution, in April 1933, President Franklin Roosevelt had issued Presidential Executive Order 6102. This order confiscated gold and silver. It required virtually all gold and silver coins, bullion, and gold certificates (US paper currency redeemable in gold) to be turned in to the Federal Reserve Bank or its branches or agents, in return for an equivalent amount of US currency not redeemable in gold. Failure to turn over gold and silver was punishable by a \$10,000 fine and/or 10 years in prison. Rare coins, jewelry, and metals needed for industrial use were exempt from this order.

By taking gold and silver out of circulation, Roosevelt's order eliminated the competition to fiat currency, leaving people with no choice but to accept paper dollars backed only by government decree. A US dollar could now be created without the necessity of acquiring a dollar's worth of gold to back it. Devaluing greenbacks was seen as a

⁸ *Bank for International Settlements, Triennial Central Bank Survey, www.bis.org/publ/rpfx13fx.pdf*

way to get out of the Depression by stimulating commerce and, especially, by making US exports cheaper and therefore more competitive. However, in a “beggar thy neighbor” policy, every other major capitalist country also abandoned the gold standard.

The more things change...

“Mr. Abe [Shinzo Abe, prime minister of Japan] made weakening an unduly strong yen a plank in his party’s campaign during national elections, which he won resoundingly in mid December. The strong, explicit rhetoric on yen levels from Mr. Abe and his deputies have sparked worries recently that Japan could be fanning the flames of a global currency war.”

—*The Wall Street Journal*, Dec. 29, 2012, emphasis ours

Completing the Transition to Fiat Currency

After 1933, people within the US could not convert dollars to gold. US trading partners, however, could and sometimes did.

After World War II, international financial exchange was governed by the Bretton Woods Agreement. That agreement required each country to adopt a monetary policy that tied the value of its currency to the value of the USD, at a fixed rate of exchange. The US in turn tied the dollar to gold, agreeing to stabilize the system by buying gold from its trading partners, or selling USD to them, at \$35 per oz. of gold.

This agreement worked reasonably well until about 1970. By then, several factors, including rebuilt, modernized industrial capacity in Japan and West Germany and the cost of the Vietnam War, had led to the United States running trade and balance-of-payments deficits. In response, the US printed more money. European nations, seeing that each dollar was backed by less gold, began to lose confidence in the USD. Not wanting to risk inflation by devaluing their own currencies, they redeemed gold for dollars at a sharply increased rate.

On August 15, 1971, President Richard Nixon shocked the US’s trading partners by closing the US Treasury’s “gold window.” The USD was no longer redeemable in gold by anyone inside or outside the United States. The era of fixed exchange rates and a fixed price for gold was over.

Tuesday, August 17, 1971

THE SYDNEY MORNING HERALD

Outcry over US\$ rescue

JAPAN GREATLY UPSET

BY NIXON MEASURES

President Nixon announced sweeping economic measure yesterday and international uproar followed

At the same time, in an effort to reduce inflation in the US, Nixon imposed temporary wage and price controls. The 90-day controls were extended three times. By 1973, they had been in effect for almost 1,000 days. These controls helped create temporary shortages of some commodities (you may remember—or remember hearing about—the gas lines of 1972-1973) but essentially failed to stop inflation in the long run.

The word “stagflation,” first used in Britain in 1965 to describe a period of rising prices but negative-to-low growth, became widely used in the US at this time. It summed up the economic conditions here in the early 1970s and at several times since. Previously, most analysts of the US economy had believed inflation occurred only during periods of strong economic growth.

Monetizing Federal Debt

Even before the Great Recession that began in 2008, the US Federal Reserve was engaged in monetizing national debt: it held \$700 to \$800 billion of Treasury notes. In late 2008, the Fed started buying \$600 billion in mortgage-backed securities (MBS). Within four months, it held \$1.75 trillion of bank debt, MBS, and Treasury notes. The sum grew to \$2.1 trillion by June 2010. This “quantitative easing,” a euphemism for monetizing national debt, became known as QE1 when it was followed by a second round of quantitative easing, QE2.

QE2, a stimulus program announced by the Fed in November 2010, would buy \$600 billion of

Treasury notes, at approximately \$75 billion per month, ending in June 2011. Like QE1, QE2 aimed at keeping interest rates down. Low interest rates enable businesses to more easily borrow money to finance expansion. They also keep mortgage rates low, in an attempt to stimulate the housing market.

Gridlock in the US Congress over increasing the debt ceiling came close to causing default in July 2011. Along with the realization that the US has no realistic plan to avoid adding to the national debt, that unnerved investors in the US and around the world and led to the unprecedented lowering of the US's debt rating from AAA to AA+ by Standard & Poor's.

In September 2011, the Fed announced "Operation Twist," a shift from holding short-term to long-term US sovereign debt. The program, to run from September 2011 through June 2012, involved selling \$400 billion of short-term debt and using the proceeds to buy long-term debt. The objective was to increase demand for Treasury bonds, thus keeping their prices high and lowering their yield.⁹ Low T-bond interest rates would supposedly encourage banks to lend to businesses and investors to buy stock or corporate bonds.

Operation Twist was extended through December 2012, with another \$267 billion of short-term debt converted to long-term debt.

By September 2012, it was apparent that despite QE1 + QE2 + Operation Twist, US economic growth was sluggish at best. The Fed then announced QE3, the \$40-billion per month mortgage-bond-purchasing program that we described earlier. QE1 and QE2 had fixed end dates. In an unprecedented effort to guarantee low interest rates well into the future, the Fed announced that QE3 had no fixed end date and would continue until at least mid-2015.

On December 12, 2012, the Fed announced it planned to hold short-term interest rates at zero to 0.25% as long as the unemployment rate remains above 6.5%. In forecasts published at the same time the Fed indicated it did not expect unemployment to go below 6.5% for at least three years.

In the same announcement, as we mentioned earlier, the Fed confirmed that it would continue the QE3 program of purchasing \$40 billion in mortgage-backed securities per month and that it will continue to buy long-term Treasury securities, "initially at pace of \$45 billion per month." The two programs together meant that the Fed created money at the rate of \$85 billion per month—\$1.02 trillion per year—through all of 2013. The Fed announced a long-awaited "taper" Dec. 18, 2013. Beginning January 2014 it reduced its money creation to \$75 billion per month—\$40 billion to purchase Treasuries; \$35 billion to purchase mortgage bonds. That still amounts to \$900 billion a year of money created by keystrokes.

Would you like to be able to borrow money interest free? US law enables the Treasury to do just when it sells bonds to the Fed. An article in *The Wall Street Journal* (Jan. 11, 2013) explains how it works. "Under law, the Fed is required to use its income to cover its operating expenses and send much of the rest to the Treasury's general fund, where it is used to pay government bills and benefits." In 2012, the Fed "sent a record \$88.9 billion in profits to the Treasury Department," out of its net income of \$91 billion. \$80.5 billion of that income came from interest payments on mortgage-backed securities and Treasuries. The Fed transferred \$77.7 million to the Treasury in 2013.¹⁰ If creating money to monetize sovereign debt is the cake, this sleight-of-hand return of interest payments is the icing.

Mushrooming Federal Budget Deficit

The US national debt as of December 2013 is \$17.2 trillion,¹¹ up from \$16.4 trillion in December 2012. US gross domestic product (GDP) for 2013 was \$15.7 trillion.¹² With a debt equal to 109% of GDP, the federal government owes more than all the goods and services produced in the US annually. The national debt has only once exceeded that ratio to GDP. In the midst of World War II, when the nation had one-third of today's population and 14.5-million servicemen and women at war around the globe, the national debt reached 120% of GDP.

⁹ Bonds are issued at a given rate of interest. If the market price of the bond goes up, the interest rate that a buyer receives on his/her investment goes down.

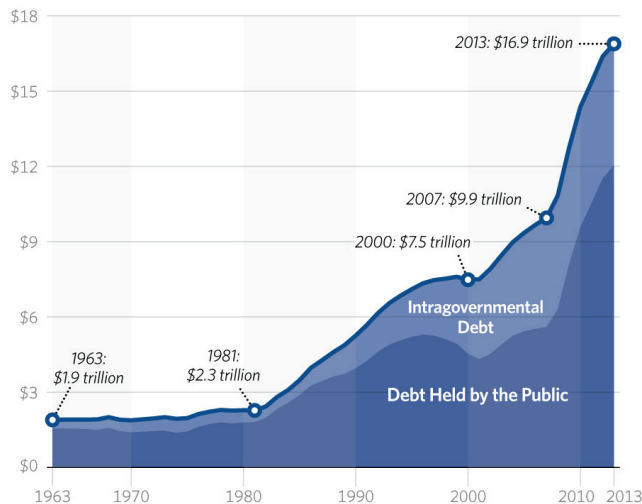
¹⁰ Marketwatch.com, Jan. 10, 2014.

¹¹ U.S. National Debt Clock, at www.brillig.com

¹² www.tradingeconomics.com

U.S. National Debt Approaching \$17 Trillion

IN TRILLIONS OF INFLATION-ADJUSTED 2013 DOLLARS



Source: Office of Management and Budget, *Historical Tables: Budget of the U.S. Government, FY 2014, Table 7.1*, April 2013, <http://www.whitehouse.gov/omb/budget/Historicals> (accessed May 8, 2013).

Federal Spending by the Numbers 2013 heritage.org

Emerging victorious from World War II as the only major country with its industrial capacity intact, the US was in a position to rapidly reduce its national debt. By 1960, national debt to GDP was about 52%; by 1981, it had reached its modern low of about 33% of GDP.

The picture today is different. US corporations must fight for market share at home and abroad against strong competitors from many other countries, including Japan, China, South Korea, Brazil, India, Germany, France and other EU countries. Among its competitors, the US is the only nation supporting a global network of military bases and significant, prolonged armed interventions. As a result, US national debt is going up, not down, at the rate of approximately \$1 trillion per year.

Interest payments have been an ever-increasing component of the national debt, even at today's rock-bottom rates. In Fiscal Year 2013, the average rate paid by the US Treasury was only 2.43%. Even at that rate, interest payments consumed 6.23% of the federal budget—\$223 billion. About 50% of that sum left the country, to pay foreign holders of US debt.

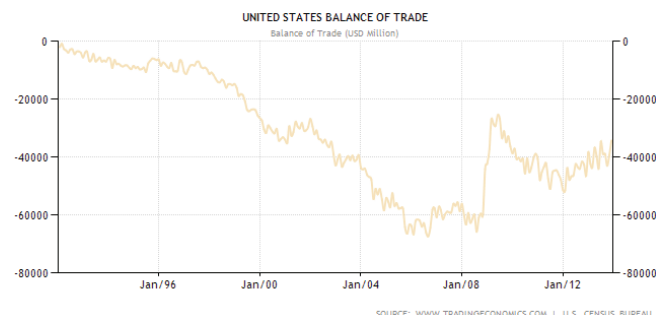
Economist David Buckner, an adjunct professor at Columbia University, sees rising interest rates as a trigger for hyperinflation. On the Glenn Beck Program he said, "Everybody says, well you're not seeing hyperinflation.... Interest rates are so low, nobody's putting that cash back into investments

in the United States. But they are putting it into desperate countries in Europe. They're putting it into other investments. And the money's going out there, so the second Bernanke raises the interest rates, all of the sudden the money sucks back into the United States and we have hyperinflation." Buckner predicted that by January 2015 if not sooner, we will see "an increase in interest rates that will start the domino."

On Oct. 2, 2013, the day Buckner was interviewed by Glenn Beck, the interest rate on the benchmark 10-year Treasury bond was 2.63%, up from 1.76% at the end of 2012. Will interest rates rise further? The evidence leaves little doubt. By the close of trading Dec. 31, 2013, the yield on the 10-year Treasury bond had risen to 3.03% — an increase of 72% for the year.

Growing Trade Deficits

Every year since 1980, the United States has paid more for imported goods than it has received for exported goods. These negative balances of trade are known as trade deficits. Prior to 1980, the US almost always had the opposite, an annual trade surplus.



SOURCE: WWW.TRADINGECONOMICS.COM | U.S. CENSUS BUREAU

The US annual trade deficit tends to decrease during recessions, when people and businesses have less money to spend, and increase during periods of economic growth. However, as the chart above shows, particularly since the 1990s, the overall trend has been for the annual trade deficit to increase (move deeper into negative numbers).

The effect of large trade deficits on prices is complicated. Importing oil contributes significantly to the trade deficit, particularly when the price of oil is high. High oil prices contribute to higher prices for gasoline and diesel fuel and almost everything else. Oil is used to make plastic and petrochemicals, to power tractors for agriculture and heavy equipment for construction,

and to transport everything to market. However, another significant part of the trade deficit comes from flooding US markets with goods from China and other low-wage countries. That keeps prices for US consumers down, producing an anti-inflationary effect.

But there's another inflationary side to that coin. What do China, Japan, South Korea, Saudi Arabia and other net exporters to the US do with the dollars they accumulate? Until recently, they have been investing most of it in US Treasury notes, in mortgage-backed securities, and in other forms of US debt. They have been "enablers" of the federal government running a budget deficit, much as family members who loan money to a drug addict enable their relative's habit.

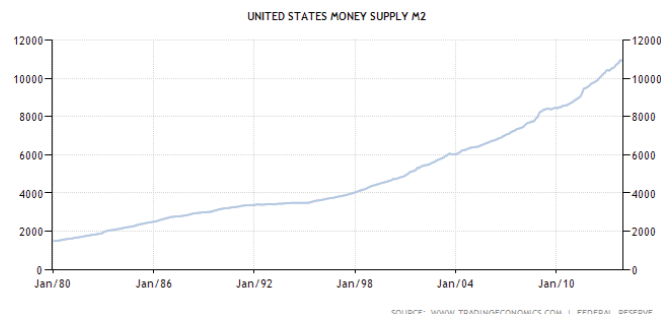
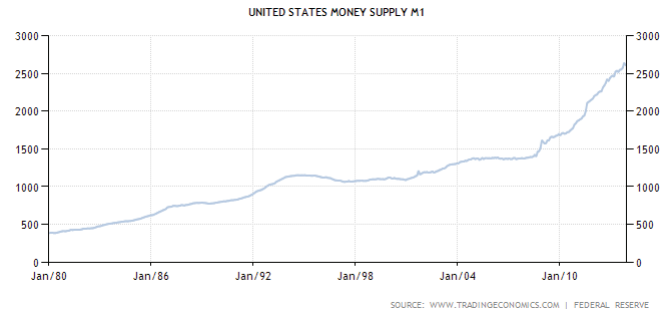
Now that the Federal Reserve has taken to creating previously unheard of amounts of dollars, China and the other creditors have cut back on their purchases of US debt. Fearful that their USD holdings will decrease in value, they are urging the US to take measures to strengthen the dollar, including curtailing stimulus programs and raising interest rates. But with unemployment remaining high in the US (and with most new jobs being low paying and/or part time), economic growth sluggish, and the housing market showing only a mild recovery, higher interest rates here would contribute to stagflation. Decades of trade deficits have put the US in a bind.

Increase in Money Supply

A sharp increase in the supply of money is characteristic of inflation and, as we will see from the experience of Germany, Argentina, and Brazil, of hyperinflation. That's because it leads to more money chasing the same amount of goods (or even a declining amount of goods, as in stagflation). The effect can be delayed for a while by banks and corporations sitting on their money and refusing to lend or invest. That's happening in the US today. Ultimately, such risk-avoidance cannot prevail. Banks make money by lending and corporations compete for market share and profits by investing in research and development, marketing, and production. When lending and investment resume, the "velocity of money" – the pace at which money moves through the economy – accelerates and inflation takes off.

As you might surmise from the Fed's creation of money to support the four QE programs, the

supply of money in the US is increasing. There are a number of measurements of money supply, all known as "M"s. M1 includes notes and coins in circulation (but not in bank vaults), traveler's checks of non-bank issuers, demand deposits (such as checking accounts) and other accounts on which checks can be written (known as "NOW accounts"). M2 includes M1 plus savings deposits, time deposits under \$100,000 and money-market accounts of individuals. These charts show the trend in each.



Social Turmoil

Inflation and its evil big brother, hyperinflation, never arrive quietly. Economic developments such as inflation, stagflation, housing crises, fiscal crises, and unemployment profoundly affect people's lives. And people react. In February and March 2011, tens of thousands of workers and students demonstrated in Madison, WI and even briefly occupied the State House to protest the termination of collective bargaining rights. The demonstrations were followed by campaigns to recall eight Republican and eight Democratic state senators.

Similar protests have taken place in Montana, Illinois, and Indiana. In California, New York, and other states, thousands of college students, faculty, and employees have demonstrated against cuts to education budgets. "Occupy Wall Street" spawned similar movements in cities throughout the US.



In November 2011, tens of thousands of people briefly shut down the port of Oakland (photo above). The Ports of Los Angeles and Long Beach — the biggest shipping complex in the US — were shut down from November 26 to December 4, 2012

by 10,000 members of the International Longshore and Warehouse Union. Perhaps most significant, in terms of generating inflation, a movement has started among low-wage workers and their supporters for a higher minimum wage, and/or a “living wage” of as much as \$15/hour. Fast-food workers and Wal-Mart workers in multiple cities have participated in demonstrations and 1-day strikes demanding a living wage. Congressional Democrats and President Obama are pushing for increasing the federal minimum wage from \$7.25 to \$10.10/hour by 2015. In California, a state with 10% of the US population, the minimum goes from \$8.00 to \$9.00 July 1, 2014 and to \$10.00 Jan. 1, 2016. In New York, the state with the third largest population, the minimum increases from \$8.00 to \$8.75 Dec. 31, 2014 and to \$9.00 Dec. 31, 2015.



Global Instability

The US demonstrations are part of a worldwide phenomenon. In many European countries, millions have marched and gone on strike against government austerity measures. In Greece, the most militant and radical elements have stoned police, smashed cars, and thrown petrol bombs at police and government buildings, including the finance ministry. In North Africa and the Middle East, demonstrations against food inflation and unemployment played a key role in driving the mass movements against dictatorial regimes.

We don't yet know the consequences of ousting some of the longtime dictators in the Middle East

and North Africa. It is clear, however, that stability has not resulted from the “Arab Spring.” The military has returned to power in Egypt and given the Muslim Brotherhood and other opponents few alternatives to taking up arms. In Bahrain, home of the US Navy's Fifth Fleet, a Sunni king has been able to maintain power over a majority Shiite population only with the intervention of the Saudi Arabian army. A full-scale civil war rages in Syria. The “peace process” between Israel and the Palestinians is once again underway, so far with no tangible results. Violence continues in Iraq (post US withdrawal) and Afghanistan (pre US withdrawal).

Violence between militias continues in Libya and political/ethnic conflict shakes South Sudan. Fighting between rebels and the government continues in Mali, despite a peace agreement. Fighting between rebels and the government also continues in the Central African Republic. The situation in Africa and the Middle East is unpredictable; one or two more shocks could put oil back to its record \$140 a barrel or beyond, with devastating effect on the sluggish recoveries taking place in the US and Europe.



Refugees from violence in South Sudan enter UN compound Dec. 13, 2013.

Meanwhile, in Asia, we see increasing tension between China, Japan, South Korea, Vietnam, the Philippines and Indonesia over, among other things, exploration rights to undersea oil and gas.

Social unrest, demonstrations, and rioting tend to make governments leery of taking economic measures, such as raising interest rates and tightening up on credit, that might create more unemployment and generate more protests. Often, as we will see from the examples of Germany, Brazil, and Argentina, social unrest drives them toward papering over the problems with money, bringing on hyperinflation and even more social unrest.

6. What Is Hyperinflation? Can It Happen in the US?

Hyperinflation has happened twice in the United States—during and after the Revolutionary War and the Civil War—and 31 times in a variety of countries during the 20th Century. We'll list all of them and describe hyperinflation in Germany, Argentina, and Brazil in more detail. We will see that many of the factors that led to hyperinflation in those countries—such as financing war through debt and monetizing debt—exist in the United States today.

First of all, what is hyperinflation?

Consumers know they are experiencing hyperinflation when the focus of their existence becomes a desperate struggle to deal with rapidly rising prices and shortages of critical commodities. Life becomes a race to find and buy food, fuel, medicine and other necessities before their prices jump yet higher.

Economists have developed more objective definitions. The International Accounting Standards Board defines hyperinflation as “a cumulative inflation rate over three years approaching 100% (26% per annum compounded for three years in a row).” At that rate, an item that costs \$10 today would cost \$20 three years from now. Your income would have to double in three years to maintain your standard of living. Your investments would also have to double in three years to maintain their value. In 1956, economist Phillip Cagan famously defined hyperinflation as an average monthly price increase of 50% or more. At that rate, your \$10 item would cost \$1,946 just one year later. Most of the 31 episodes of hyperinflation in the 20th Century followed the Cagan model.

Hyperinflation Struck Iran in 2012

Recent developments in Iran illustrate that hyperinflation can strike fast, and that governments quickly move to restrict or block escape routes such as withdrawals from bank accounts, buying/owning gold, or foreign currency exchange. Suddenly, you discover that it is too late to avoid severe losses.

Relative to the US dollar the Iranian rial (IRR) declined in value by 71% from October 2011 to December 2012, with most of the drop occurring from May to October 2012. An Iranian who held IRR that could have been exchanged for US\$100,000 in October 2011 could get US\$29,000 for the same number of rials in December 2012. That's the black-market rate. The official rate declined only 22%. Ordinary Iranians, however, have limited or no access to the official exchanges.

That same Iranian could have invested that US\$100,000 in gold in October 2011, when the average price of gold was US\$1,665 per oz. In October 2012, he or she would still have the same amount of gold, with an average price that month of US\$1,747. Instead of being down 71%, our investor would have been up 4.9%.

By October 2012, Iranians trying to salvage their remaining savings were out of luck. "Iranian police officers moved to arrest unlicensed currency dealers...to prevent unofficial trading from disrupting new government-imposed rates of exchange for the national currency," reported *The New York Times* (Oct. 8, 2012). A few days earlier, the Iranian government had moved to suspend gold trading by ordinary citizens.

With the new president in Iran, the beginning of negotiations over Iran's nuclear program, and the lifting of some economic sanctions, the Iranian economy has improved and the currency has stabilized, although at a level far below its pre-hyperinflation exchange rate.

"It Can't Happen Here"

The specter of hyperinflation is frightening. We can make ourselves feel better by pooh-poohing the possibility of hyperinflation happening in the United States in the 21st Century. Reality, however, does not respect wishful thinking. Think back to 2006-2007, when housing prices began to drop. An endless stream of bankers, economists, politicians, and journalists assured us that the crisis would be restricted to subprime mortgages and would be over within a year. In 2008, they assured us that within a year we would see a marked decrease in unemployment and an upswing in the housing market. Today, many of these pundits assure us that even ordinary inflation hardly exists.

If you believe that hyperinflation is even a possibility – and I believe that after examining the evidence in this article you will – why put your head in the sand? Instead, obtain true peace of mind by preparing to survive and prosper. Such preparation is especially sound because it protects

you from the ordinary inflation we are currently experiencing.

Let's look at three examples of hyperinflation and see what we can learn from them that sheds light on what we may soon face.

Do You Own or Manage A Business?

After analyzing hyperinflation and related matters, such as potential changes in government policy, this booklet will focus on how to prepare as an investor. If you are a business owner or manager as well as an investor, we urge you to read an 82-page book by University of Arizona economist Gerald Swanson, *The Hyperinflation Survival Guide*. Dr. Swanson and his team studied the strategies that enabled some businesses in Bolivia, Brazil, and Argentina to succeed during hyperinflation while others went under.

7. The History of Hyperinflation

Germany

The German experience demonstrates that hyperinflation can occur in a large country with a democratic government and a highly developed capitalist economy. Therefore, we will examine it in some detail.

In 1914, the German mark, like most other currencies, was redeemable in gold. When Germany went to war that year, its central bank, the Reichsbank, suspended redemption. Rather than alienate its population through increasing taxes, Germany financed its war by borrowing. Unable to sell enough bonds on the market, Germany monetized its debt by having the Reichsbank buy bonds. The Reichsbank could print unlimited amounts of fiat money to do so.¹³

When World War I ended in November 1918, Germany's national debt had increased 1,700% and money in circulation had increased by a factor of four. By 1918, the consumer price index (CPI) was up 140% – less than one might expect given the run ups in the debt and the money supply. Price inflation had been kept down by rationing and low demand. Millions of soldiers in the trenches were not in the marketplace. Civilians, hard at work to support the war effort, had little time for leisure. Money was piling up and not being spent.

The German government had expected to win the war and force the defeated countries to pay its debt. After losing the war, there was great incentive to continue printing money to monetize the debt and finance promised social programs. From November 1918 to February 1920, prices shot up another 400%.

After 15 months of relative stability, prices surged again, rising 700% in 14 months. France, claiming Germany was not living up to its agreements to pay reparations for war damages, occupied the Ruhr. Germany sponsored “passive resistance” and paid citizens in the Ruhr not to work.

Germany injected so much money into the economy that businesses everywhere but the Ruhr were operating at full capacity, with full

¹³ “Fiat” is defined as “official sanction” or “arbitrary order.” “Fiat money” or “fiat currency” refers to currency backed only by governmental edict (or “fiat”) rather than by an asset such as gold or silver. Sometimes “paper money” is used to mean fiat currency.

employment. However, prices rose so quickly that, despite frequent wage increases won by unionized industrial workers, real wages plummeted. Farm workers, white-collar workers, and professionals lost ground even faster. Germans, losing all confidence in the mark, immediately spent every mark they could get their hands on. If someone could buy 10 jackets, he'd do it, knowing that they would keep their value and could be used for barter.



German postage stamps, 1921-1923. Each stamp is worth ten times the value of the stamp to its left.

By 1923, Germany was printing notes with denominations as high as 100-trillion marks. At the height of hyperinflation, in December 1923, a 100-trillion mark note would get you \$23.81 at the official rate.

Housewives burned 100-million-mark notes for heat; it was cheaper than buying fuel. Business owners turned into speculators in commodities. Farmers kept their produce rather than sell for marks that lost half their value in two days. Food riots broke out; groups of workers went to farms and seized food. Businesses closed; unemployment surged; chaos reigned.

The German government passed monetary reform decrees that forbade the old central bank from buying government bonds, thus stopping the printing of marks. It also created a new bank, the Rentenbank, which issued a new currency, the Rentenmark. To build confidence in the Rentenmark, the quantity in circulation was regulated. The goal was to have sufficient currency for government and commercial transactions, but not to issue credit to the government or speculators.

The Rentenmark was supposedly backed by mortgages on land and bonds on factories. However, the land and factories could not be turned into cash or used for foreign exchange. What gave the new currency real strength was gold. Although

the Rentenmark was not redeemable in gold, it was backed by bonds indexed to the price of gold. The value of these “gold bonds” was defined at the same fixed rate as pre-war gold marks, 2,790 Rentenmarks per kilogram of gold.

Paper marks and Rentenmarks circulated together, with up to 1,200 quintillion¹⁴ paper marks in circulation. In 1924, the German treasury issued a new currency, the Reichsmark, equal in value to one Rentenmark. A monetary law permitted the exchange of a trillion marks for one new Reichsmark. This rate of exchange gave back to people a fraction of what they had lost, because 3-trillion marks were the equivalent in purchasing power of one new Reichsmark.

Krupp, Thyssen, Farben and other major German industrial conglomerates emerged strong from hyperinflation. They had supported the government’s inflationary policies because a weaker mark made their products cheap to foreign buyers, enabling them to increase exports. Their exports were paid for in sound foreign currencies with which they could buy raw materials to import into their plants in Germany. Millions of middle-class people, workers, and farmers, however, saw their savings wiped out and their lives destroyed. Embittered, many of them supported the Nazi party in its rise to power.

Bloomberg News reported November 27, 2012 on a speech that Richard Fisher, president of the Federal Reserve Bank of Dallas, gave that day: “Fisher said there are lessons to be learned from Germany’s experience of hyperinflation during the 1920s. While today’s situation is different and he wasn’t suggesting accommodative monetary policies would lead to inflation, Fisher said they can’t be left in place forever. ‘There is no such thing as QE infinity,’ he said. ‘QE infinity gets you into trouble.’ Fisher has been one of the minorities on the Fed who has opposed quantitative easing.

Argentina

Under a military dictatorship from 1976 to 1983, Argentina went into debt to finance the Falklands war, government takeover of the debts of failed banks, and projects that were not finished (and therefore produced no revenue). Unemployment reached 18%. The military junta became extremely unpopular and ceded power.

As part of its plan to stabilize the economy, the newly elected civilian government introduced a new currency, the austral, and took out new loans. Tax revenue did not increase quickly enough to pay the interest on the debt. The central bank reacted by printing money and monetizing national debt, using a variety of tricky financial maneuvers to conceal its actions.¹⁵ Despite the deception, public confidence in the austral plummeted. Prices increased by 10 to 20% per month. July 1989 saw a sharp increase in the monthly inflation rate—to 200%. For the year 1989, prices went up 5,000%. Real wages fell 50% from 1983 to 1990. Rising prices and declining real wages led to riots and the resignation of the president in favor of the president-elect.



Hyperinflation continued into 1990. In 1991, the Argentine government stopped inflation by fixing the value of the austral at 10,000 to the USD, with full convertibility. Later, a new Argentine peso replaced the austral, and convertibility was fixed at one peso per USD.

Convertibility created a new set of problems. The fixed exchange rate made many imports more affordable than domestically produced products, causing a constant outflow of dollars. The central bank had to buy dollars to support convertibility. Meanwhile, the flood of imports caused factories to close and unemployment to rise. Public spending on unemployment benefits and on corrupt payments to private corporations and wealthy individuals rose, causing the national debt to continue to grow. Widespread tax evasion exacerbated the problem.

Argentina sold off many state companies at prices favorable to the buyers, who were cronies of government officials. The revenue generated by this 1-time fix was quickly spent. Argentina then financed its debt largely by external borrowing, particularly from the International Monetary

¹⁴ A quintillion is 10-million trillion.

¹⁵ See Argentina: From Insolvency to Growth, A World Bank Country Study, pp. 180-185, available on Google Books.

Fund. By 1999, the economy was in a recession that lasted three years.

By 2001, foreign investors were withdrawing funds from the country and Argentines, fearing the worst, started withdrawing money from their savings accounts and sending dollars abroad. To stop the run on the banks, the government froze all accounts for 12 months, except for withdrawals of small sums. This led to a new form of protest—masses of people in the streets banging pots and pans. The crowds also smashed windows at banks, companies that had been privatized, and European- and American-owned businesses.

In 2002, Argentina defaulted on its debt and abandoned the fixed 1-to-1 exchange rate. Hyperinflation returned. The peso quickly devalued to about four to the USD, with no increase in wages. Businesses failed and the unemployment rate reached 25%.

A recovery started in 2003. Exports surged due to the devalued peso, which also discouraged imports, strengthening those local businesses that had survived. Rising soybean prices and huge exports of soybeans to China brought a flood of foreign currency into Argentina. Simultaneously, the government took measures to increase revenue by strengthening tax collection.

Brazil



Brasília—the futuristic city that replaced Rio de Janeiro as the capital of Brazil—was built in four years, from 1956 to 1960. It was a remarkable achievement: the unpopulated, arid area in the interior of the country had resembled a desert. A problem became apparent years later. The government of Brazil had financed the project by printing money.

Unfortunately for the Brazilian people, the unfunded construction of Brasília was not a 1-time extravagance. It started—or at least reinforced—a

trend that continued for decades. Public projects included a “bridge to nowhere.” Unlike its never-built Alaskan counterpart, this bridge reached halfway across a canyon before construction was stopped. Corruption was also rife; a high government official diverted public funds to build privately owned (by him) apartment buildings, and never went to jail.

Brazil’s federal debt also increased when the government:

- Had to make good on guarantees to the Mortgage Assistance Fund.
- Was unable to collect on debts that had been listed as assets on its balance sheet.
- Bailed out failing banks.

To pay its debts with devalued currency, Brazil cranked up the printing presses higher and higher. The table below shows the effect on prices.

<i>Price Levels in Brazil, 1980 to 1997</i>	
Year	Consumer Price Index
1980	4
1981	8
1982	16
1983	38
1984	111
1985	362
1986	895
1987	2,940
1988	21,435
1989	328,113
1990	100,000,000
1991	500,000,000
1992	5,600,000,000
1993	113,600,000,000
1994	2,472,400,000,000
1995	4,104,400,000,000
1996	4,751,200,000,000
1997	5,080,300,000,000

Source: International Monetary Fund Financial Statistics

People became used to living with a high rate of inflation. Some forms of income, such as some wages and interest, were even indexed to the CPI. But the effects of compounding plus loss of confidence in the currency brought hyperinflation,

destroying businesses, jobs, and savings. As the table shows, in 1981 prices were “only” double what they had been in 1980—a 100% increase. By 1985, the annual rate of increase was over 200%. 1989 saw a huge jump, to 1,400%, followed in 1990—the worst year—to 30,000%.

At the peak of hyperinflation, price increases were measured in hours. Storeowners and managers could not change price tags to keep pace. Instead, they put colored stickers on products, and changed prices all at once on color-coded charts displayed on walls and at cash registers. (Such crude measures may not be necessary when hyperinflation strikes the US. Some supermarkets and other large stores have already introduced electronic pricing. An employee at a computer can remotely change the price of any, or every, item in a store, or in an entire chain of stores. The price tag at the register changes simultaneously with the price tag on the shelf. Talk about anxiety on the checkout line!)

Brazilian hyperinflation was brought under control in the late 1990s through a number of measures that included raising taxes and interest rates, reducing government spending, and introducing a new currency, the real, that was indexed to the USD.

Common Elements

The three examples of hyperinflation above had features particular to each country. I’m sure, though, that you were struck, as I was, by the elements they had in common. Hyperinflation in Germany, Argentina, and Brazil was characterized by the following:

- Fiat currency not backed by gold and not pegged to another, stable currency.
- National debt increasing at an accelerating pace, not sustainable without major increases in tax revenue and major cuts in spending.
- Financing of wars through debt (Germany and Argentina).
- Government bailouts of failed financial institutions (Argentina and Brazil).
- Printing ever-increasing amounts of currency, ultimately resulting in total loss of confidence.
- Central bank monetizing government debt (Germany and Argentina).

- Sudden, unexpected change from ordinary levels of price inflation to hyperinflation. (A Brazilian businessman described it as “waking up on a roller coaster.”)

The table below lists 28 other episodes of hyperinflation in the 20th Century that show the same common elements.

Countries that experienced hyperinflation in the 20th century		
Country	Period	Ratio of hyper-inflated currency to currency issued to curb hyperinflation
Angola	1991-1995	1 billion to 1
Argentina	1975-1991	1 billion to 1
Austria	1914-1923	N/A
Belarus	1994-2002	1,000 to 1
Bolivia	1984-1986	1 million to 1
Bosnia & Herzegovina	1992-1993	N/A
Brazil	1986-1994	2,750,000 trillion to 1
Bulgaria	1996-1997	3,000 to 1
China	1948-1949	10,000 to 1
Free City of Danzig	1922-1923	10,000,000,000 to 1
Georgia	1993-1994	1,000,000 to 1
Germany	1922-1923	1,000,000,000,000 to 1
Greece	1942-1944	50 trillion to 1
Hungary	1922-1923	N/A
Hungary	1945-1946	4×10^{29} to 1
Israel	1971-1985	N/A
Krajina	1992-1993	50 billion to 1
Mexico	1982-1993	1,000 to 1
Nicaragua	1987-1990	50 billion to 1
Peru	1988-1990	1 billion to 1
Philippines	1942-1944	N/A
Poland	1921-1924	1.8 million to 1
Poland	1989-1991	10,000 to 1
Republika Srpska	1993	N/A
Romania	1990s	10,000 to 1
Russian Federation	1921-1922	1,000 to 1
Taiwan ¹⁶	1940s	40,000 to 1
Ukraine	1993-1995	100,000 to 1
Yugoslavia	1989-1994	10^{27} to 1
Zaire	1989-1996	3×10^{11} to 1
Zimbabwe	2006-2008	10^{25} to 1

¹⁶ Prior to the arrival of the Kuomintang.

China's Concern about the "Tiger" of Inflation

"China's premier, Wen Jiabao, warned last month that inflation is like a tiger—once unleashed, it is 'very hard to cage again.'"¹⁷ Have you ever wondered why the Chinese government is quick to raise interest rates and restrict credit to keep their economy from growing too fast? As the table on page 25 shows, hyperinflation struck China in 1948-49. Tens of millions of Chinese peasants, workers, and professionals blamed the Kuomintang government for the financial losses they suffered from hyperinflation and threw their support to the Chinese Communist Party (CCP). On October 1, 1949, in control of most of the countryside and almost every major city on the Chinese mainland, the CCP established the People's Republic of China.

Even before that, in December 1948, the CCP issued the original renminbi¹⁸ as part of its effort to control inflation in the areas it governed. To this day, the leaders of China are acutely aware of the fury of the masses against their government when hyperinflation strikes. Therefore, they try to walk a fine line between controlling inflation and keeping employment high.

The Chinese people are also acutely aware of the dangers of hyperinflation—they've heard about the suffering from their parents and grandparents. That's one reason why they are so motivated to own gold and have been buying it at an accelerating rate since it became legal for them to do so.

8. Interest Rates and the Price of Gold

All central banks, including the Fed, operate on the assumption that their chief weapon for fighting inflation is increasing interest rates. They also tend to believe that even tiny increases in interest rates will curb inflation by slowing economic growth and giving investors alternatives to buying gold and silver as inflation hedges. However, in the 1977-1980 gold bull market, the price of gold rose even while the US prime interest rate reached 11% and tripled with the prime at over 15%. A combination of even higher interest rates and wage and price freezes finally sent the country into a recession and gold into a bear market.

How high did interest rates have to go to win investors to sell gold and buy bonds or CDs? When gold peaked in January 1980, the prime rate—the rate at which banks loan to their most creditworthy customers, such as large, profitable corporations—was 15.75%, rising to a high of 20% by April. The United States is in a different place today, facing much stiffer global competition, much higher federal deficits and national debt, and much more committed to stimulating the economy through prolonged low interest rates. In 1980 the US federal debt was below \$1 trillion. With its debt now above \$17 trillion—and having to constantly borrow money to make debt payments—it's virtually inconceivable that the federal government would allow interest rates to approach those levels unless the US dollar

were already essentially worthless as a result of hyperinflation.

In August 2011 Fed Chairman Ben Bernanke took the unprecedented step of announcing that the federal funds rate (the rates at which banks make overnight loans to each other, annualized) would remain in the 0.25–0.5% range for two years, through August 2013. Never before had the Fed told investors how long a rate would be in effect. However, that rate turned out to be not low enough. In a press release dated Sep. 13, 2012, the Federal Open Market Committee (FOMC) announced its intention to keep the inflation pedal to the metal until well after the economy strengthens,

To support continued progress toward maximum employment and price stability, the Committee expects that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the economic recovery strengthens. In particular, the Committee also decided today to keep the target range for the federal funds rate at 0-0.25% and currently anticipates that exceptionally low levels for the federal funds rate are likely to be warranted at least through mid-2015."

¹⁷ The Wall Street Journal, April 15, 2011.

¹⁸ "Renminbi" is the official name of the currency, which is more often referred to as the yuan.

This “expectation” became Fed policy with the December 2012 announcement of QE4. And in his final press conference, Dec. 18, 2013, Bernanke announced the Fed’s intention to keep short-term interest rates low “well past the time” when the official unemployment rate falls below 6.5%.

So low a funds rate holds the prime rate at around 3.25% — a far cry from the 15-20% rates that helped kill the gold bull in 1980. We should also note that it takes substantial real interest rates to halt a gold bull market. The real interest rate is the difference between the nominal interest rate and the rate of inflation. For example, if in 2015 the interest rate has risen to 15% but the rate of inflation is 20%, making the real interest rate negative 5%, the gold bull market would probably be surging rather than ending.

Trends in Chinese gold demand illustrate this point. In the first quarter of 2009, when real interest rates in China spiked, demand for gold decreased sharply. By the first three months of 2011, demand has risen again, with one quarter of the gold sold in the world being bought in China. Chinese gold consumption was up 47% over the same period the year before — despite four increases in Chinese interest rates. To combat inflation the Chinese government raised interest rates on 12-month bank deposits from 2.5% to 4.5% — an 80% increase. Yet the number of tonnes of gold purchased by Chinese citizens increased, as did the price of gold in yuan.

Economist Vincent Reinhart, a former director of the Federal Reserve Board’s Division of Monetary Affairs, says Fed policy may be moving toward “Generate Inflation Now,” a play on President Ford’s “Whip Inflation Now” campaign. Reinhart says Bernanke, along with Bank of England (BOE) Governor Mervyn King, are considering holding interest rates at or close to zero even if inflation rates rise above their 2% “target rate.” Sure enough, on October 6, 2011, BOE announced it would buy £75 billion of government bonds in a fresh bout of quantitative easing aimed at stimulating the UK’s stagnant economy. BOE’s Monetary Policy Committee agreed to finance a second round of asset purchases with newly created central bank money to ensure that the inflation rate didn’t fall below its 2.0% target over the medium term.

In early November 2012, the BOE announced that it was terminating its QE program early. However,

the announcement was essentially fraudulent. As assistant editor Jeremy Warner blogged in the *Daily Telegraph* (Nov. 9, 2012), “What the Treasury has decided to do is take the accumulated interest payments on the stock of government debt the Bank of England has bought under quantitative easing, and credit it to the Government’s books rather than the Bank of England’s. The total is £35bn, of which the government intends to take £11bn this financial year and £24bn next.”

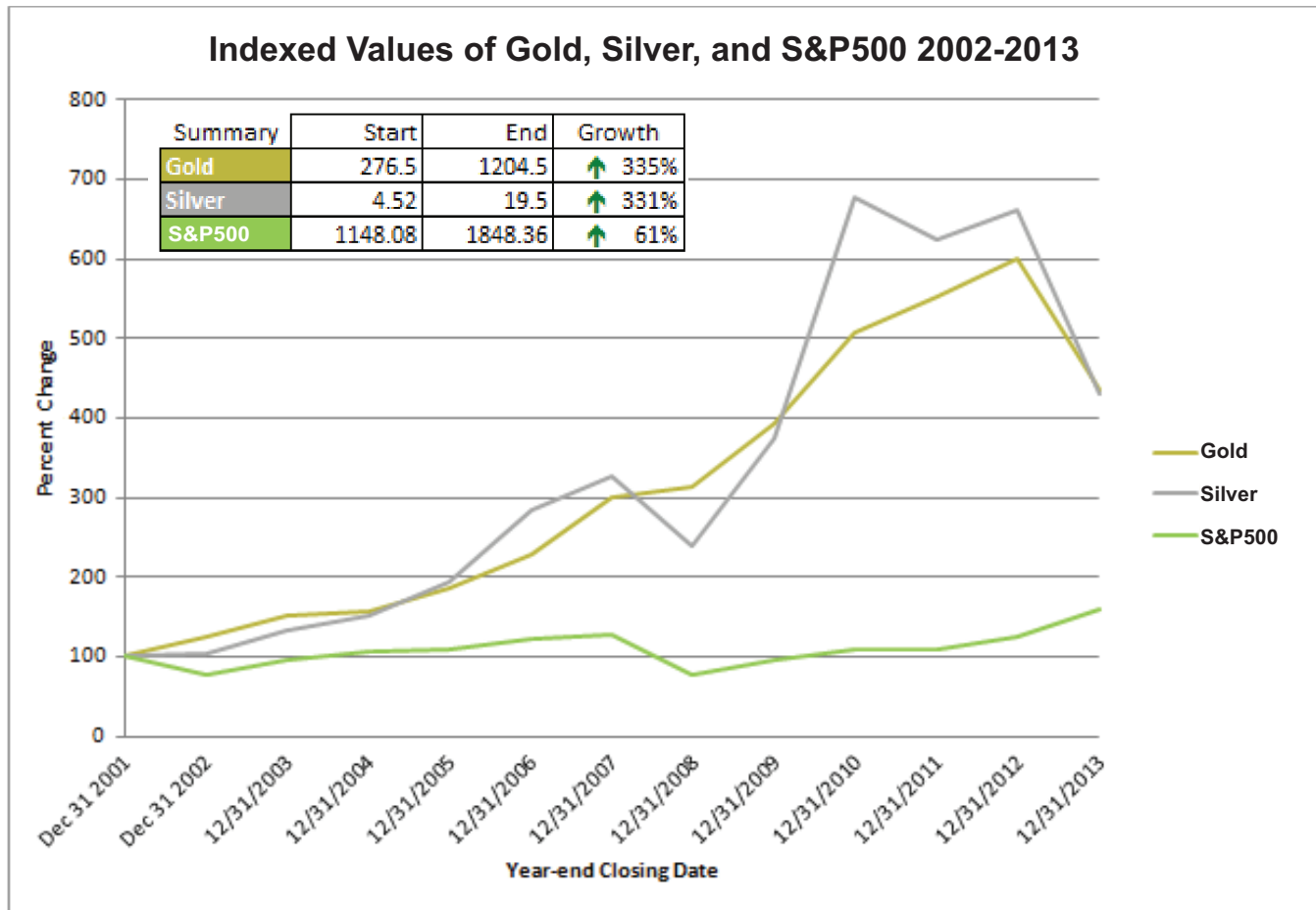
This is quite a trick. If continued (and there is no announced termination date), it means the British Treasury is off the hook for interest payments on about 30% of its debt. Would anything stop the BOE from turning over the principal as well when the bonds it owns mature? QE programs monetize debt; turning over interest monetizes debt under a different name.

The Bank of Japan (BOJ) too is picking up the QE pace. According to the *Daily Yomiuri* (Dec. 22, 2012), “The Bank of Japan’s decision to undertake additional monetary easing was in response to Liberal Democratic Party President Shinzo Abe’s call for aggressive measures by the bank ahead of the launch of the new Abe-led administration next week....The bank decided to implement monetary easing steps, the fifth such decision this year.

“The bank has been increasing the amount of its asset-purchase fund since the fund was created in October 2010 with 35 trillion yen. With the latest monetary easing measures, the amount of the fund will exceed 100 trillion yen.” One hundred trillion yen equals US\$1 trillion—a major monetizing move.

There is no end in sight to the Japanese government’s efforts to stimulate inflation and make the yen more competitive against the euro, the renminbi, and the US dollar. According to *The Japan Times* (Dec. 20, 2013), the BOJ’s Policy Board “decided unanimously to continue the central bank’s radical quantitative easing policy going. The policy, launched in April, aims to double the nation’s monetary base by buying up government bonds to artificially stoke 2 percent inflation in two years.... Under its radical monetary policy, the BOJ is conducting market operations to increase the monetary base at an annual pace of about 60 trillion to ¥70 trillion by gobbling up government bonds and more risky debt.”

9. Invest to Preserve Your Wealth



Gold (London PM fix) closed 2001 at \$276.50 oz. It closed 2013 at \$1,204.50, for a 12-year increase of 335%. The equivalent figures for silver are \$4.52, \$19.50, and 331%. The equivalent figures for the S&P500 Index are 1148.08, 1848.36, and 61%.

These remarkable performances by the precious metals come despite gold's decline from its September 2011 record high of \$1920.80 and silver's from its April 2011 high of \$49.84. The S&P500, by contrast, closed 2013 at an all-time high.

Despite gold and silver outperforming just about any other asset category by far for over a decade, you would be hard pressed to find a story about the metals on the cover of a magazine (even a business or finance magazine) or on the front page of a newspaper (even of the business section, and even when gold was setting record highs). In fact, the stories on gold that did appear in the mainstream media were mainly about why stocks and bonds were better investment vehicles. This is in marked contrast to Phases II and III of the run-up to January 1980, when the gold mania

resembled the Internet mania of the 1990s.

Lack of media attention and negative media are evidence that we are nowhere near the top of the long-term bull market in precious metals. Investing in gold and silver therefore remains an excellent way to protect your assets and even profit from inflation and/or hyperinflation. Of course, when Phase III of the bull market arrives and everybody is buying, you would want to be selling or trading for gold and silver products that have less volatility and can protect you from what comes next.

Own Physical Gold and Silver

There are many ways to invest in gold and silver, from physical metal, precious-metal ETFs, and mining shares to derivatives such as futures and options. Since 2004, I have strongly recommended to my friends and clients that they own physical gold and silver, because ETFs and mining shares have risks and problems that are not acceptable. (See page 34 for the reasons why.)

Hyperinflation is generally accompanied by social, political, and economic turmoil. Often stock markets and banks are shut down by the government for periods of time, or withdrawals from bank accounts are limited by government

decree. I advise my clients to store their gold in a home safe or safe deposit box providing direct, immediate access. I advise them not to allow third parties to hold, store, or delay delivery of their precious metals.

10. Prepare for Possible Gold Confiscation

For most people, it's hard to accept an idea that is out of the mainstream, and harder still to act on it— to “pull the trigger.” That's why most people get swept along and harmed by “black swan” events, such as the collapse of the housing market, and relatively few profit from them.

Now I'm going to raise an idea that might seem unlikely at first—the possibility of a gold confiscation. Of course, given that it's happened in the US twice before (under President Lincoln to help finance the Civil War and under President Franklin Roosevelt during the Great Depression), it would be wise to think about why and how it might happen again.

Let's discuss the motives for a potential gold confiscation by the federal government and then the means by which the government could implement it.

Motives for Gold Confiscation

For motive, we have only to look at the 1933 gold confiscation. The government wanted to print money not backed by gold and wanted it to be universally accepted as payment for “all debts public and private.” But people were accustomed to currency that was convertible into gold. By and large they didn't convert it, but they knew they could.

If gold coins and paper currency backed by gold were still in circulation, competing with the new fiat currency, which would people want? Sure, stores might accept the fiat currency because the law required them to, but a parallel market would likely have developed, with gold coins and gold-backed bills more desirable and, therefore, having more purchasing power than their face value. We've seen similar scenarios many times in countries suffering from high inflation. A parallel market denominated in a foreign currency in which people still have confidence develops. That currency was typically the USD.

In addition, in 1933 the government still needed

gold to back dollars used in international trade. But the Federal Reserve was printing billions of fiat dollars. By confiscating gold coins and “paying” for them in fiat dollars, the federal government was able to increase its gold holdings at zero cost other than the expense of administering the program. The value of gold held by the Federal Reserve increased from \$4 billion to \$12 billion between 1933 and 1937.¹⁹ Some of that difference is presumably the result of the change in price from \$20.67 to \$35 per oz. Adjusting for that, it appears that the confiscation brought in about 228,571,428 oz. of gold. The gold confiscation was essentially a bailout of the Federal Reserve. Like the recent bailouts of big financial institutions, it was publicly financed. The recent bailouts were financed through taxes and loans; the confiscation through snatching gold from people's pockets and purses and replacing it with paper.

Today, US residents are buying more gold than ever before. They are stocking up on the US Gold Eagles & Buffalos, Canadian Gold Maple Leafs and popular European small denomination gold coins. Many financial advisors—including some brokers at Goldman Sachs, Morgan Stanley, and other major financial institutions—are advising their clients to put a small portion of their portfolios into gold. That's an about face from the advice most were giving only a few years ago. As US inflation intensifies and confidence in the USD declines further, the trend toward investing in gold will accelerate.

One of the federal government's motives for confiscating gold could, therefore, be the same as it was in 1933: to avoid competition for its fiat currency.

Another motive might be to increase revenues without seeming to raise taxes. How so? US residents forced to turn in their gold in 1933 were compensated at \$20.67 per oz. The United States Gold Reserve Act of January 30, 1934 ordered

¹⁹ en.wikipedia.org/wiki/United_States_Bullion_Depository

the Federal Reserve to turn the gold over to the US Treasury and changed the price of gold to \$35 oz. (the price set for international gold-USD transactions until 1971.) In the eight months from May 1, 1933 to January 30, 1934, the federal government made a profit of \$14.33 on every oz. of confiscated gold. That's a 69.3% profit. At a \$14.33 profit per oz. on 228,571,428 oz. of gold, that comes to \$3.28 billion. The entire federal budget for Fiscal Year 1933 was \$4.6 billion.

In a modern confiscation, the same profit motive would apply, although it would work a little differently. The government would presumably pay the market price for gold, or a fixed price close to the market price. But the confiscation would occur at a time of an acutely weakening dollar and a sharply rising gold price, when holders of gold could likely have gotten a significantly higher price in months, weeks or even days. Furthermore, the very act of confiscating gold would increase the global price of the precious metal by taking gold out of circulation and putting more fiat dollars into circulation.

Given that the government might have two motives for confiscating gold—eliminating competition to fiat dollars and increasing revenue—would it have the means?

Means of Gold Confiscation

The 1933 confiscation was done by an executive order issued by President Roosevelt. The executive order was based on powers granted to the executive branch by the 1917 Trading with the Enemy Act (TWEA). In 1971, President Nixon “closed the gold window” to international holders of dollars, also via an executive order. His act was known as the “Nixon Shock” because it was issued on a Monday morning before the US stock market opened and without consultation with US trading partners, the US Congress, or anyone outside a small group of advisors in the executive branch.

UNDER EXECUTIVE ORDER OF THE PRESIDENT

Issued April 5, 1933

all persons are required to deliver

ON OR BEFORE MAY 1, 1933

**all GOLD COIN, GOLD BULLION, AND GOLD
CERTIFICATES now owned by them to
a Federal Reserve Bank, branch or agency, or to
any member bank of the Federal Reserve System.**

Does the President still have the legal power to confiscate gold? Could he do it by executive order, without consultation with Congress, and by surprise? In 2005, Chris Powell of the Gold Anti-Trust Action Committee (GATA) wrote to the US Treasury Department essentially asking those questions. He received a reply from Sean M. Thornton, Chief Counsel (Foreign Assets Control) of the Treasury Department, dated August 12, 2005.²⁰ Thornton referenced TWEA as giving the President the power to confiscate gold or, basically, any other asset, to “prevent certain transactions that might be of advantage to an enemy during wartime.”

Powell had also asked if the President has the power to confiscate shares of gold and silver mining companies if some of the shares were held by foreign nationals or foreign governments. Thornton replied, “Under TWEA during times of war – and also under the International Emergency Economic Powers Act...during peacetime national emergencies – the president has broad powers to regulate property in which there exists a foreign interest.”

Talking about means of confiscation, we should note that ownership of gold through ETFs makes it easy. Rather than deal with millions of individual investors, the government can seize the gold from the ETFs' storehouses, wire transfer money to each ETF, and let the ETFs pay off investors through their brokerage accounts.

Rare US gold and silver coins were exempt from the 1933 confiscation. This made sense because neither of the motives for confiscating the precious metals applied. Rare coins are by definition scarce, so there would never be enough of them to compete

²⁰ www.gata.org. “Treasury claims power to seize gold and silver – and everything else.” October 6, 2007.

with fiat dollars as currency. Furthermore, while each modern US Gold Eagle bullion coin is “worth its weight in gold,” each grade of each type pre-1934 US gold and silver coin has a value in excess of its precious metal content due to its scarcity established over 80 years or more.

For the same reasons of scarcity and lack of uniform value, it would make no sense for the government to try to profit from confiscating rare coins. There aren’t enough of them and running the program to find them, buy them, and sell them would cost more than it would generate in revenue.

Therefore, part of a program to prepare for hyperinflation should involve investing in non-bullion gold and silver coins.²¹

*I recommend buying only coins authenticated, graded, and encapsulated by NGC or PCGS, the most reputable third-party grading services. The US gold and silver investment quality coins I recommend are listed in the most recent **CoinStats** report.*

CoinStats is an in-depth statistical analysis of popular pre-1934 gold and silver coin series that enables investors to identify the best values in certified rare coins. We are proud to offer this unique and outstanding investment tool exclusively to our clients. I also recommend many popular pre-1934 world gold and silver coins, which I consider low-premium, “bullion-plus” investment items. Many long-term gold and silver coin investors and collectors prefer owning US gold and silver type coins and rarities graded Mint State (MS) 63 or higher. These coins have shown excellent capital growth over the long term. There is a liquid market for investment grade coins, including electronic markets in which authenticated, graded, and encapsulated coins are traded sight unseen.

A gold and silver confiscation would almost certainly be kept secret until it was announced, so it makes sense to begin investing in non-bullion gold and silver coins now. Another reason for doing so is that the prices of US pre-1934 gold and silver coins have lagged gold and silver bullion, due to the soft US economy. History has shown that unusual situations of this type don’t last long.

²¹ “Non-bullion coins” are relatively scarce gold and silver coins, mainly pre-1934 issues, which, because of their numismatic value, are worth more than the precious metals they contain.

As there is no right price for the wrong coin, financial advisors and investors should work with an experienced numismatic professional such as a member of the Professional Numismatists Guild (PNG). PNG members have a minimum of five years’ experience in the field, submit to a background check, and are required to abide by a code of ethics and to submit disputes to mediation and arbitration.

India Tightens Up on Gold

All governments with high trade deficits and weakening currencies get nervous when more and more people look to gold as a store of value. *Reuters* (Aug. 19, 2013—*in.reuters.com*) documented measures taken by India in 2013 to limit gold imports. Until overtaken by China last year, India was the world’s largest importer of gold. The measures included

“Jan 21 – The government raises gold import duty by 2 percent to 6 percent.

“Jan 22 – The government more than doubles duty on raw gold to 5 percent. [“Raw gold” refers to gold that has been refined from ore but not yet fashioned into bars.]

“Feb 28 - India proposes a transaction tax of 0.01 percent on non-agricultural futures contracts including precious metals.

“March 1 - Finance minister appeals to people not to buy so much gold.

“March 18 - The Reserve Bank of India [RBI, India’s central bank] says it is examining banks that sell gold coins and wealth management products to identify ‘systemic issues’, with a view to closing any legal loopholes.

“May 3 - The RBI restricts the import of gold on a consignment basis by banks.

“June 3 - Finance minister says India cannot afford high levels of gold imports and may review its import policy.

“June 5 - India hikes gold import duty by a third to 8 percent.

“June 24 - India’s biggest jewellers’ association asks members to stop selling gold bars and coins, about 35 percent of their business.

“July 10 - India’s jewellers could continue a voluntary ban on sales of gold coins and bars for six months. [Some tried to continue selling, but the government clampdown on imports in August mostly prevented it.]

“July 22 - The RBI moves to tighten gold imports again, making them dependent on export volumes, but offers relief to domestic sellers by lifting restrictions on credit deals.

“July 31 - India hopes to contain gold imports well below 845 tonnes that were shipped last year, Finance Minister says.

“Aug 13 - India hikes import duty on gold for a third time in 2013 to 10 percent. Duties for silver and platinum also increased to 10 percent. Customs duty on gold doré bars, ore or concentrate increased to 8 percent from 6 percent. [A gold doré bar is a semi-pure alloy of gold and silver, generally made at a mine, then transported to a refinery for additional purification.]

“Aug 14 - India turns the screws on gold buying again, banning imports of coins and medallions and making domestic buyers pay cash.”

Traditionally, Indians give gifts of gold jewelry to brides and for the Hindu, Jainist, and Sikh holiday of Diwali. Because these measures have reduced

the supply of gold in India and raised its price in rupees, some Indians are turning to purchasing silver instead. If this trend continues into the fall wedding season and Diwali holiday in 2014 (October 23-27), it could be one more reason to include silver in your precious metals investments.

A French Preliminary to Gold Confiscation?

The French government (and financial institutions and investors worldwide) is nervous about the high exposure of French banks to Greek sovereign debt. Perhaps that is one of the reasons that France amended its legal code in July 2011 to grant the government the power to limit or ban bullion sales (on all metals) by decree, without having to pass an act of parliament.

Beginning in October 2011 France forbade its citizens from buying precious metals with cash. They had to pay by check, postal or wire transfer, or credit card, or face a fine of €1,500/oz. In legislation passed May 23, 2013, France made it illegal to send cash and all forms of precious metals by mail.

11. Prepare for a Possible Return to the Gold Standard

United States currency was on the gold standard for 134 years.

From 1792 until 1933 (or 1971 for foreign holders of USD), with the exception of 1862-1868 (during and immediately after the Civil War), the US Dollar was backed by gold or silver. Based on that history alone, it would be a mistake to assume without considering the evidence that the dollar will never return to the gold standard.

States Take the Lead in Bringing Back the Gold Standard

As typically happens when there are sharp and accelerating increases in money supply, people begin to question the value of their currency. State governors and state assemblies and senates are responding.

In May 2011, Utah passed the “Sound Money Act,” stating that US gold and silver coins could be accepted as legal tender. The law does not require that the coins be accepted only at their face value (much lower than their market value), leaving open the possibility of making purchases with the precious metals accepted at their full value. The

same law eliminated state capital gains taxes on gold and silver.

Larry Hilton, a Utah legislative attorney who wrote the Sound Money Act, has been a guest on my weekly KABC radio show. Larry and I have discussed putting together a blue ribbon panel of gold/silver, banking, and depository experts to advise Utah’s governor and legislators on how best to implement the legislation.

At least 11 other states have proposed legislation similar to Utah’s. Although several of the bills lost in committee or in a full chamber of the legislature, they are likely to be brought up in future sessions. These states include Georgia, Idaho, Indiana, Minnesota, Missouri, Montana, New Hampshire, North Carolina, South Carolina, Tennessee, and Virginia.

Two state laws edging toward a gold standard went into effect in 2013. Texas eliminated sales taxes on all precious metals beginning Oct. 1. The bill categorizes gold and silver as currency, making them ineligible for collection of sales tax under state law. A similar law went effect in August in Louisiana. That state had previously taxed gold

and silver purchases of under \$1,000. The new law eliminated that threshold.

On June 28, 2011, US Senators Mike Lee (R-UT), Jim DeMint (R-SC, now president of the Heritage Foundation), and Rand Paul (R-KY) introduced the Sound Money Promotion Act, S. 1287. This bill would make gold and silver legal tender and eliminate capital gains taxes on gold and silver coins.

A return to the gold standard could result from federal legislation or a mandate from a majority of the 50 states. It would freeze the value of gold at a set price (estimated anywhere from \$2,500 to \$10,000 an oz.) at which the United States Government would buy or sell gold. The US would no longer be able to print money without a direct relationship to gold.

Is a Return to the Gold Standard a Fringe Idea?

Robert Zoellick was president of the World Bank from July 2007 to June 2012. Before that he was a managing director of Goldman Sachs and a United States Deputy Secretary of State. According to *Market Watch* (November 7, 2010), "World Bank chief Robert Zoellick said in an article in the *Financial Times* that leading economies should consider 'employing gold as an international reference point of market expectations about inflation, deflation and future currency values.' Zoellick made the proposal as part of reforms to be considered at this week's G-20 meeting in Seoul. 'Although textbooks may view gold as the old money, markets are using gold as an alternative monetary asset today,' said Zoellick. He said such a reform would reflect economic realities and should be considered as a successor to the existing global currency paradigm known as 'Bretton Woods II.'...Zoellick said a return to some sort of currency link to gold would be 'practical and feasible, not radical.'"

Robert Zoellick is not a fringe player, and Alan Greenspan is not a fringe economist.



Robert Zoellick



Alan Greenspan

Interviewed on *Fox News* (January 21, 2011), Greenspan said, "We have at this particular stage a fiat money which is essentially money printed by a government and it's usually a central bank which is authorized to do so. Some mechanism has got to be in place that restricts the amount of money which is produced, either a gold standard or a currency board, because unless you do that all of history suggest that inflation will take hold with very deleterious effects on economic activity.... There are numbers of us, myself included, who strongly believe that we did very well in the 1870 to 1914 period with an international gold standard."

What's behind this seemingly amazing reversal by Greenspan? The USD is under siege. It's been able to function as the world's reserve currency since the Bretton Woods Agreement, even after Nixon took the USD completely off the gold standard in 1971. The single most important manifestation of the USD's reserve-currency status is petrodollars—the pricing of oil in dollars. Until recently, every buyer of oil in the world had to accumulate dollars with which to purchase oil. Oil is sold at the rate of about 88-million barrels per day. At \$100 a barrel that's \$8.8 billion a day. But, more and more, oil producers are making deals to sell oil for currencies other than the USD, such as the euro or

the yen, or thus lessening the demand for dollars. Iran, for example, created a bourse that accepts payment for oil and petroleum products only in euros or Iranian rials.

Additionally, more and more countries are agreeing to direct exchanges of their currencies, eliminating the need to use the USD as an intermediary vehicle. For example, Russia and China have initiated direct exchange between the renminbi and the ruble. According to *Reuters* (March 2, 2011), “China hopes to allow all exporters and importers to settle their cross-border trades in the yuan by this year, the central bank said on Wednesday, as part of plans to grow the currency’s international role. In a statement on its website (www.pbc.gov.cn), the Central Bank said it would respond to overseas demand for the yuan to be used as a reserve currency.”

Scholar and investment banker Lewis Lehrman was one of the original members of the United States Gold Commission, authorized by Congress during the Reagan Administration to study the possibility of returning to the gold standard. In October 2011, Mr. Lehrman gave a lecture in Washington DC, at the Heritage Foundation, in which he laid out a 5-step plan for returning to the gold standard.

At its national convention in Tampa in August 2012, the Republican Party passed a plank in its platform calling for a new commission to research fixing the value of gold to the USD. (*BBC News*, August 30, 2012)

The 113th (currently sitting) Congress has not acted on or conducted further investigation into the gold standard—hardly surprising, as they have not acted on much of anything else.

If a return to the gold standard were to occur, it would have two effects on the price of gold in USD:

- A significant additional increase in the price of gold. There are a lot of dollars to be backed. Assuming that the gold believed to be stored in Fort Knox is there, and hasn’t been leased out, it’s estimated that gold would have to be priced at over \$6,000 per oz. to fully back each greenback.
- An end to the appreciation in the price of gold, by returning to a fixed-dollar exchange rate.

Even the prospect of congressional action on a return to the gold standard would send investors searching for a liquid hard asset that could continue to appreciate. Once again, pre-1934 US and world gold and silver investment coins would provide an answer.

12. Own Physical Gold and Silver, Not Paper Assets Such as ETFs or Mining Shares

Many investors view GLD, SLV, and other ETFs that hold precious metals as easy ways to own gold. After all, you can buy and sell online, and there appear to be no storage costs (of course the 0.5% per year you pay in management fees includes storage). We’ve already mentioned that, in the event of a confiscation, the gold and silver bullion held by ETFs would be easy pickings for the government, while pre-1934 US gold and silver coins would be exempt and would shoot up in price. Here are nine other reasons why you are better off owning physical precious metals than investing in ETFs. Later, we’ll talk about the dangers inherent in owning shares in gold and silver mining companies.

Nine Reasons Why I Do Not Recommend GLD, SLV or Other Precious-Metals ETFs

The following information is based on GLD’s prospectus. SLV’s prospectus is similar.

1. Shares are not redeemable for physical gold except in “baskets” of 100,000 shares. (A share represents 0.1 oz. of gold; 100,000 shares = 10,000 oz. At \$1,200 per oz, a basket would represent about \$12 million.)
2. There is no hedge against volatility of paper assets, because GLD is a paper asset.
3. A depleting investment: fractions of gold holdings are liquidated to offset management and other fees, at approximately 0.5% a

year, or \$6.00 per year per oz. with gold at \$1,200; \$30 an oz. with gold at \$6,000. Each sale of gold by the trust is a taxable event to shareholders; therefore shareholders receive a 1099-B every year with a tax liability. This diminishes the overall underlying assets per share, which leaves an investor with a share value of less than one-tenth of an oz. of gold over time.

4. Higher reporting requirements; less privacy.
5. Shareholders receive an annual 1099-B and are taxed on the gross proceeds (see #3 above) less commissions.
6. Capital gains on gold and silver ETFs are taxed at 28%, rather than the 15-20% rate on long-term capital gains for other investments of one year or more.
7. Zero benefit in a worst-case scenario (see #9 below).
8. No outside independent audit of the quantity or quality of gold is permitted.
9. Counterparty risk: In "The Problem with GLD and SLV ETFs" (December 14, 2008), Trace Mayer writes, "The reassertion of **counter-party risk** is driving much of the risk in the current markets. Page 10 of the GLD prospectus states, 'If the Trust's gold is lost, damaged, stolen or destroyed under circumstances rendering a party liable to the Trust, the responsible party may not have the **financial resources** sufficient to satisfy the Trust's claim.' On page 9, 'The Trust does not insure its gold.' Further on page 12, 'Gold held in the Trust's unallocated gold account and any Authorized Participant's unallocated gold account will **not be segregated** from the Custodian's assets. If the Custodian becomes **insolvent**, its assets may **not be adequate** to satisfy a claim by the Trust or any Authorized Participant. In addition, in the event of the Custodian's insolvency, there may be a delay and costs incurred in identifying the bullion held in the Trust's allocated gold account.' Gold is not subject to counter-party risk or in other words the financial ability of a counter-party to pay. Clearly, GLD is impregnated with counter-party risk that may instantly and violently appear from within like the Alien."

Unlike GLD and other precious-metal ETFs, bullion coins do not require an annual 1099-B form, do not have management fees, and do not diminish in value by 0.5% a year.

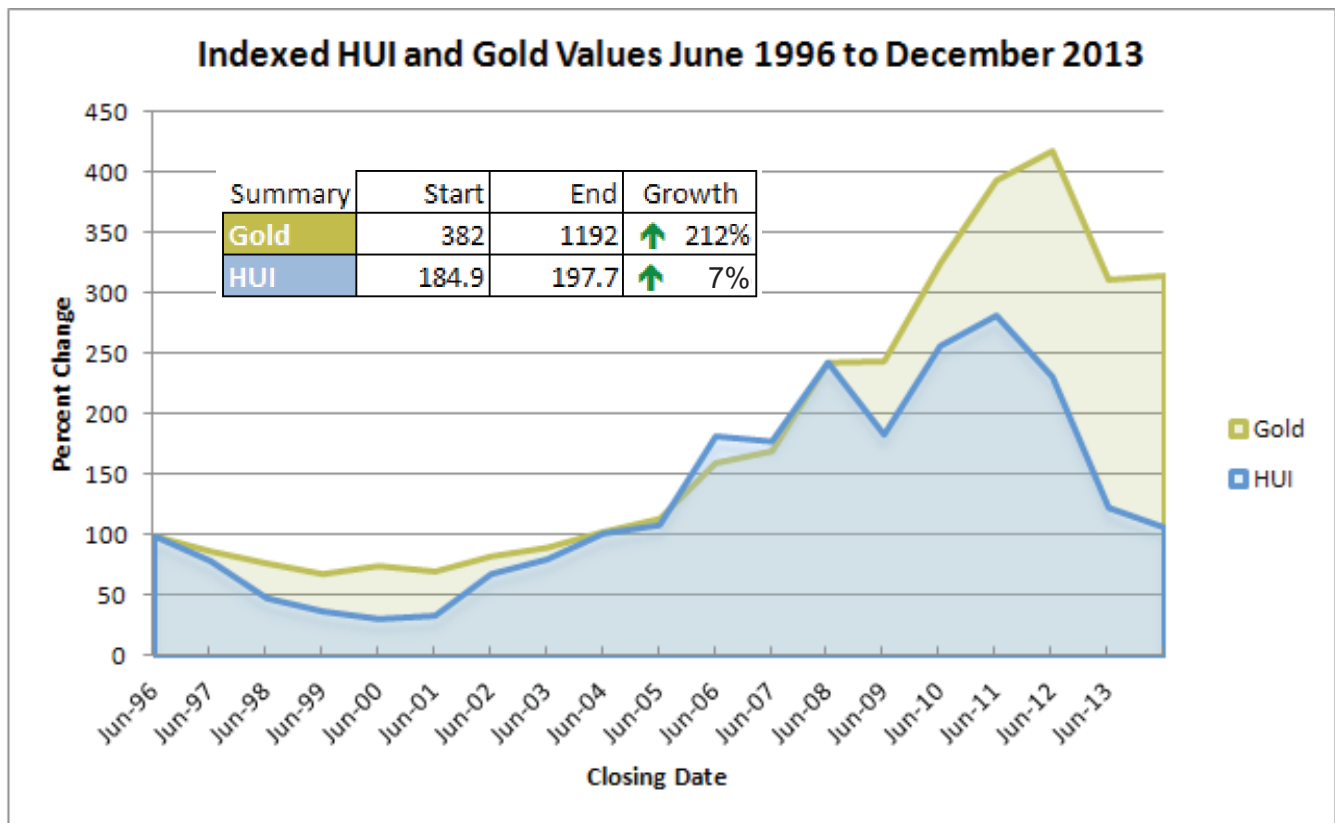
The Disconnect Between Bullion and Mining Stocks and Funds

The price of most mining shares has lagged far behind the rise in the price of gold. The chart on page 36 compares the NYSE Arca Gold BUGS Index (HUI) to the price of gold, measured by the London PM gold fix. "BUGS" stands for "Basket of Unhedged Gold Stocks." The Index consists of 15 major gold mining companies that do little or no hedging. Hedging refers to selling gold in advance at a fixed price, rather than at the market price. Unhedged mining shares should, theoretically, closely reflect the price of gold. But from 1996, when the HUI was founded, through the end of 2013, the index is up only 7%, while for the same period gold is up 212%. As we explain below, the spread is only going to get wider.

Many market analysts believe that this lag represents an anomaly in the market that will soon self-correct.

Another popular explanation for the lag is that the relationship between physical gold and mining stocks got disrupted when the financial markets went haywire in 2008, and equities tumbled while physical metal increased.

Although many of these market analysts are highly respected, my research leads me to say, "None of the above." I believe that the main problem is the increasing risk of higher labor costs and third-world producing countries hiking their export fees, along with the strong possibilities of union strikes and government nationalizations and increasingly costly safety, health and environmental regulations. All of these risks cause the price of physical precious metals to increase while mining stocks drop or continue to lag. Sophisticated investors, particularly institutional investors, apply a "risk discount" to a mining company's proven and probable reserves.



Here are a few examples of what concerns me about owning shares in mining companies:

We start with **Peru**, the world’s number-one exporter of silver and number-six exporter of gold. President Ollanta Humala campaigned on a promise to impose additional taxes on mining companies whose profits had swollen on lofty global commodities prices to fund social programs in a country where a third of the people are poor despite a decade-long economic boom. (This feeling is shared by many underdeveloped countries with natural resources.) On September 28, 2011, the president signed a bill that imposed a “windfall profits tax” of 2–8.4% of net profits and raised royalty payments from 1–3% of sales to 1–12%.

Chile increased its royalty rate on mining activity in October 2010 to a range of 5% to 14% on operational income, replacing a fixed 5% royalty. The tax is progressive; it increases as income increases. Following the collapse of the Copiapó mine in 2010, Chile stepped up safety inspection and enforcement. “Eighteen mines were shut down and a further 300 put under threat of possible closure.”²² In November 2012, Chile’s National Geology and Mining Service suspended

Barrick Gold’s mining operation at their Pascua Lama plant due to a contravention of health and safety laws.²³ Barrick has delayed plans for first production at this giant mine for two years, to mid-2016. According to *Forbes* (July 1, 2013), “Barrick had to suspend work on the Chilean side [the mine, high in the Andes, straddles the Chile-Argentina border] in April, where most of the mine’s orebody sits, because of a Chilean court’s preliminary injunction that was issued due to the environmental concerns of indigenous communities....On the Argentinian side of the project, where most of the critical infrastructure is located, labor costs are soaring.”

April 2012 saw the Chilean Supreme Court uphold an earlier decision to cancel the environmental permit granted to Canada’s Goldcorp for the El Morro gold and copper mine (a \$3.9 billion project), following pressure from aboriginal groups.²⁴ While all these measures may benefit the Chilean people, there is no question that they raise the costs of mining and reduce profits.

In August 2012, **Bolivia** expropriated the operations of Canadian-owned South American Silver in

²² en.wikipedia.org/wiki/2010_Copiapó_mining_accident

²³ www.seekingalpha.com

²⁴ www.whoslegal.com/news/analysis/article/30159/research-trends-conclusions-mining-2013

Mallku Khota. According to the company, this is “one of the world’s largest undeveloped silver, indium and gallium deposits.” South American Silver had succeeded in gaining acceptance of their project from 43 of 46 indigenous communities.²⁵ In October 2012, Hugo Morales’ government passed the world’s first ruling that grants all nature equal rights to humans. The “Law of Mother Earth ... redefines the South American nations’ mineral deposits as ‘blessings’ and is supposed to lead to radical new conservation and social measures to reduce pollution and control industry.”²⁶

Then President Hugo Chavez nationalized **Venezuela’s** gold mining industry in August 2011. His action gave the government total control over all gold production and exploration within Venezuela. Chavez also repatriated \$11 billion in Venezuelan gold reserves previously held by US and European central banks.

Tanzania, one of Africa’s top gold producers, followed the example of other producer countries and passed a “super profit” tax on earnings from minerals as one of the ways to fund its 5-year development plan. As *Mining.com* reported (July 30, 2012), “The gold-rich African nation... introduced a 30% corporate tax for mining companies in operation for more than five years, stating that the move is justified by rising precious metal prices on the international market.” Despite the decline in precious metals prices, Tanzania collected \$43 million through this tax from May to November 2013, according to *East African Business Week* (Dec. 16, 2013).

In **Australia**, a Minerals Resources Rent Tax (MRRT) of 30% of profits went into effect July 1, 2012. So far it applies only to mining iron ore and coal, but in the discussions leading up to the tax many politicians had their eyes on gold and other minerals as well. In addition, several Australian states and territories are contemplating higher taxes on miners. Meanwhile, “mining costs in Australia also remained under pressure. The average cost of producing a troy oz. of gold in the first half of the year was \$US856, up from \$US756 a year earlier. General inflationary pressures, a skilled labour shortage and lower output at a number of properties drove costs higher.” (*The Australian*, September 5, 2012)²⁷

25 Paul Kellogg, *PolEcon.net*, September 5, 2012

26 www.mining.com, October 29, 2012

27 www.theaustralian.com.au

The mining industry initiated a legal challenge against the MRRT, but in August 2013 the High Court of Australia ruled that the tax was constitutional. In December 2013 Australian Federal Treasurer Joe Hockey introduced legislation to repeal the MRRT. Thus far, Labor Party opposition has blocked repeal.

The risk of continued wage inflation for miners is a global problem. Barclays Capital analyst Gayle Berry said that one of the top causes of inflation has been labor, with an acute shortage of skilled manpower looming in some countries. Canada’s mining sector, she said, is forecast to have a shortfall of almost 100,000 workers in the next decade, with 65% of the hiring requirement simply to replace retired workers. Plugging that hole will be tough and expensive. “The first impact is on mine production costs, which are going to continue rising, and the second impact is the potential for delays to new projects, or at the very least a slower realization of projects in the pipeline,” Berry said. Once again, a combination that will increase the price of bullion but put downward pressure on the price of mining shares.

Western Australia is a flashpoint for labor costs, with mining companies competing for skilled labor with several large natural gas projects. “Investors are wary of investing in new gold mining projects in Australia because of the high cost of achieving production in that region,” said John Meyer, a mining analyst at Fairfax Investment Bank.” (*Reuters*, January 8, 2011)

In **South Africa**, according to *Reuters* (November 15, 2012), “The last of a wave of illegal strikes that have swept South Africa’s mining sector ended... after workers accepted an offer from Anglo American Platinum Ltd., the world’s top producer of the precious metal.



“South Africa’s platinum and gold sectors have been rocked for months by often violent wildcat action, spawned by income disparities and a union turf war for members, and more conflict could be sparked by looming job cuts and wage talks next year.

“The labor unrest has rattled investors in the continent’s largest economy and has claimed the lives of over 50 people, including 34 shot dead by police in one incident in mid-August....

“The company has offered either an additional monthly allowance of 600 rand (\$67.42) or a monthly salary increase of 400 rand, as well as a one-off 4,500 rand....

“South Africa’s boardrooms and politicians may breathe a sigh of relief as the worst labor unrest since the end of apartheid in 1994 winds down, but uncertainties still cloud the picture.

“The dominant National Union of Mineworkers, which has delivered above-inflation wage hikes but contained militancy, has lost control over much of its rank and file, a source of concern to the ruling African National Congress and corporate bosses alike.”

A year later, labor unrest in South Africa is even worse. *Mining.com* (Dec. 18, 2013) reports, “The National Union of Metalworkers in South Africa (Numsa) has “declared war” on its sister union, the National Union of Mineworkers (NUM), and by extension, the country’s biggest trade union federation Cosatu. Numsa’s General Secretary Irvin Jim announced that his union would ‘openly recruit in the mining industry and welcome NUM members.’... NUM’s membership issues are much deeper. Over the past year the union has lost many workers to its rival, the Association of Mineworkers and Construction Union (Amcu). During the summer Amcu ousted NUM as the official union of the world’s third biggest platinum miner, Lonmin.

“Just last week the world’s biggest platinum miner, Anglo American Platinum, said that after five months of recruiting Amcu now represents 60% of its shaft workers.

“The turf war between Amcu and NUM has killed dozens of people. Last month a former NUM shop steward was gunned down – the fourth person with ties to NUM to have been murdered over a

three-month period.”

Another fear of owners of mining shares recently became public. The US Department of Justice announced that Hecla Mining has agreed to pay more than \$263 million to settle environment claims.

Geoff Candy (*Mineweb.com*, September 4, 2012) reported that “while global production was at best flat,” gold mine cash costs jumped an average of 19% in the first half of 2012. “According to *Thomson Reuters GFMS’s Gold Survey 2012 Update 1*,” Candy wrote, “some of the reasons...are declining grades across the industry, construction and commissioning delays and slower than expected ramp-ups of output at a number of properties. Added to this, the group said, were exogenous factors like geotechnical problems, extreme weather and labour strikes.”

No wonder *Forbes* (July 1, 2013) sums it up this way:

Gold mining companies, however, have managed to underperform gold in both good gold markets and bad—with the underperformance getting exceptionally ugly in the down times. Gold miners have given investors little upside when the price of gold rises and handed them serious losses when gold falls. Gold producers have consecutively underperformed gold since 2006...[Gold] mining companies spent \$45 billion on projects and acquisitions since 2010 with another \$15 billion of spending still scheduled, but gold output has declined to 17.4 million ounces from 18 million ounces in 2010. Deutsche Bank put out a report recently called “The End Of Big Gold?” questioning if the big capitalization North American gold producer model is “fundamentally broken.” The report pointed to the rise of resource nationalism and tax grabs, accounting measurements that mask true operating costs, an overreliance on equity issuance to fund capital expenditures and acquisitions—and huge cash pay packages to gold mining CEOs that have nothing to do with share performance.

It Comes Down to Supply and Demand

Jeff Clark, senior precious metals analyst at Casey Research (www.caseyresearch.com) posted an insightful article Jan. 2, 2014 that sums up why the

factors we've discussed in this section will lead to a slump in gold supply. Under the title, "New Trend Guarantees Higher Gold Prices," Clark writes,

The following four factors are combining to diminish gold supply....put together they're creating a perfect storm that will, sooner or later, impact the gold market in several powerful ways. As these forces gather steam, you'll want to make sure you've already built a substantial position in physical bullion.

Factor #1, says Clark, is production pullbacks, development delays, and exploration cancellations related to the fall in the price of gold that makes many mining operations unprofitable and reduces the incentive to explore for and develop new mines. This cannot be easily reversed, even when the price of gold rises again. Shuttered mines take time to bring back online, and new mines take about 10 years to develop, even if they succeed in getting permits.

Factor #2 is "high-grading." The 29% drop in the price of gold in 2013 made it unprofitable to mine low-grade ore. As a result, many mines are

extracting ore only from their higher-grade zones. The problem is, some low grade ore needs to be mixed with high-grade ore to enable profitable refinement. Once the high-grade ore is used up, the low-grade ore may never be mined.

Factor #3, says Clark, is governmental greed. As we described above, many countries have sharply increased the taxes, royalties, and ownership demands they impose on mining companies, diminishing incentive to explore, bring mines into production, or expand production.

Clark's factor #4 is the "implosion explosion" that, as we have shown, is destroying gold production in South Africa, which has dropped from being the world's top gold producer as recently as 2006 to fifth place now.

Recommendation

Sell stocks and funds with mining operations in the many countries mentioned above and switch into physical gold and silver. Physical gold and silver will increase in price should there be nationalization of mining companies and/or as costs continue to increase and production continues to decrease.

13. Conclusion: Action and Timing

The massive debts of the US, the Eurozone nations, Great Britain, Japan and many other countries are being dealt with primarily by devaluing the currencies involved. Given the political realities in these countries, it is unlikely they will be dealt with in any other way until severe inflation forces the issue. The currencies are being devalued through "printing" – actually electronically creating – money. The newly created money is used to bailout insolvent central governments, banks, states, municipalities and financial corporations. The process goes under many names, including quantitative easing, bank re-capitalization, economic stimulus and even "job creation."

It may take a few years, but as the velocity of money going through our economy increases, it will drive down US unemployment and reenergize our real estate market. However, we will also see serious global inflation with a high likelihood of

hyperinflation within the United States. By the time we reach that stage many of the central banks of economically strong nations such as China, India, Brazil and Russia will have exchanged much of their US Dollar holdings for gold, helping push the price of gold to over \$6,000 per oz. We are also likely to see some governmental regulations, restrictions, limitations or additional taxes on gold investors by that point, in an attempt to slow the exodus from paper money. The price of silver will be over \$100 per oz. How much over will depend on the strength and speed of the global economic recovery and any barriers to ownership implemented by western nations.

As chairman of the our industry's Political Action Committee (www.goldandsilverpac.com), I will be speaking with legislators and lobbyists to closely watch how the US Congress, the controlling political party and the President deal with the dollar exodus

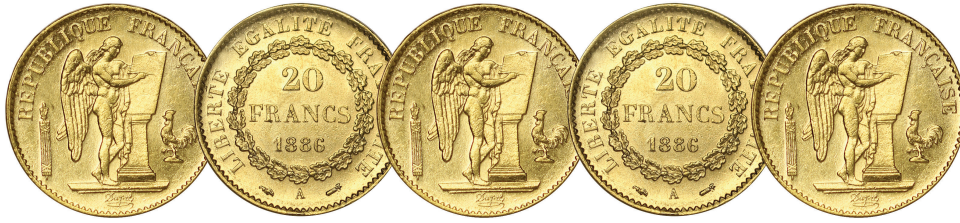
and the onset of serious inflation. This will give me a better understanding of whether we are heading for new regulations concerning precious metals, a gold and silver confiscation or a gold standard. I'll update you about such changes in my daily blogs on my website, www.mintstategold.com, and in my *Weekly Market Reports*, which are emailed to clients every Monday.

I have shared with you why I believe our country is experiencing inflation and is likely to suffer hyperinflation soon. If your assets are stored primarily in US dollars, you need to act now to protect your family, wealth, and future. I recommend that you invest a minimum of 35% of your financial capital in precious metals.

(Most of the financial planners I work with are recommending 20-25%.) Please see the insert in this booklet, or contact me, for a breakdown of the best way to invest in precious metals at the present time.

A gold standard would lead to a freeze on the value of gold bullion coins, as our government would set an official price at which it would buy or sell gold. Only pre-1934 gold and silver investment coins with numismatic value could continue to appreciate in price. Gold confiscation would make ownership of modern bullion coins illegal; investment-quality coins would continue to be legal and freely traded—the only game in town.

PRE-1934 GOLD AND SILVER INVESTMENT COINS



French 20 Franc Gold Angels Dated 1876-1898



British Gold Sovereigns Dated 1902-1925



Swiss 20 Franc Gold Helvetias Dated 1897-1933



French 20 Franc Gold Roosters Dated 1906-1914



US Morgan Silver Dollar Rolls Dated 1878-1921

For more information, visit
Barry's daily blog at
www.stupplerblog.com
and
Stuppler & Company's website
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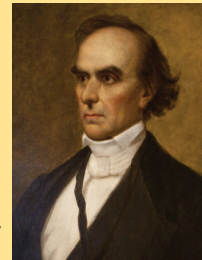


**Paper money
eventually returns to its
intrinsic value – zero.**

~ Voltaire

**We are in danger of being overwhelmed with
irredeemable paper, mere paper, representing not
gold nor silver; no sir, representing nothing but
broken promises, bad faith, bankrupt corporations,
cheated creditors and a ruined people.**

~ Daniel Webster



**With the exception only of the
period of the gold standard,
practically all governments of
history have used their exclusive
power to issue money to defraud
and plunder the people.**

~ Friedrich Hayek



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