

Gold

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A ROTHSCHILD BANKER LOOKS AT GOLD

THE EMERGING BULL MARKET

by Ferdinand Lips

INTRODUCTION: It is an honor and a pleasure to publish the following article on gold by Ferdinand Lips, the Managing Director of Rothschild Bank, Zurich, Switzerland. Mr. Lips is one of Europe's leading hard money men. It is rare to find a banker who has a thorough understanding of free market economics and, particularly, the Austrian School of Economics, including the works of F. A. Hayek and Ludwig von Mises. This thorough knowledge of free market economics and the long-term implications of government intervention in the economy have helped him to become one of the few bankers who is consistently years ahead of his time in predicting long-term investment trends. Every prudent investor should seriously consider the implications of this important article.

As a managing director of Zurich's Rothschild Bank, Ferdinand Lips handles the portfolios of a large number of prominent European families. He was co-founder and first vice-president of the Swiss Society of Security Analysts and is author of the German best seller "The Book of Investments".

Lips has lectured widely and is quite well known in Europe as an expert on gold, the stock and bond markets. Lips has been recommending the purchase of gold and gold mines since 1968. He has written numerous articles on financial and investment topics for leading newspapers and periodicals in Switzerland, Germany and other countries. He has an outstanding investment record and has been a major factor in the success of the Rothschild Bank in Zurich, having been a co-founder and director of the bank for the past 14 years.

I would like to tell you how I see the world: We human beings have been driven out of paradise, not only because we have eaten that famous apple but because we have preferred to taste the other apple, the apple of inflation. And this remains our position today. We have long been driven out of the paradise of stable currencies and pure capitalism. There is

little chance that we might return there soon. To the contrary, we are moving away from it every passing day.

In order to understand the role of gold and its future we have to distinguish two important functions: First: Gold as the monetary metal that regulates the money supply automatically. This is a historical fact. Secondly: Throughout history gold has been the number one store of value.

1. The gold standard

The gold standard has been the greatest and most beneficial of all historical changes. The purchasing power of money could no longer be influenced by the caprices of interventionist governments. It stabilized money's value in such a manner for which our present day monetary "medicine men" and politicians have not even found a substitute which is half as successful. The great advantage of the gold standard lies in the fact that it united the advanced nations of this world into a supra-national economic and monetary community. It thereby created in a particularly successful way some sort of world money. And all the ingenious theories about the foolishness of the gold standard, all the satires about the busy digging out of the

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“ After reaching a high of \$200 in December of 1974, gold 'crashed' to \$100 an ounce in August of 1976, or nearly THREE TIMES its price 6 years earlier.

After reaching a high of \$875 in January of 1980, gold 'crashed' to \$300 an ounce on June 21, 1982, or THREE TIMES its price 6 years ago, in 1976.

How high will it go before it crashes to \$900 an ounce, 6 years from now? ”

John McFalls

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barbarous relic and all the puzzling projects of gold free currencies do not remove the most important fact that human beings don't change.

Just think of the Special Drawing Rights which the former French President Giscard called monetary LSD. I also particularly liked what a Swiss banker said about the SDR's. He said he would have more confidence in them if his wife asked him for a necklace made out of them.

Dr. Janos Fekete, Chief executive of the Hungarian National Bank, once said: "About 300 high carat economists who consider gold as a barbarous relic of the dark ages, are opposed to 3 billion people who believe in gold. The problem is how can these 300 people convince the other 3 billion".

This is one of the main reasons why the gold currency became a superior and most practical currency order.

The gold standard did provide a much more stable money unit than any paper money standard, or any standard based on a commodity other than gold.

The gold standard, in essence, was based on nothing else but a readiness and determination of each individual government to stick to the rules. And this readiness was based on deep economic, political and moral convictions. Each country had to conduct its affairs as if there existed in fact a world currency.

The gold standard broke down because this readiness disappeared. Instead of monetary internationalism which was a foregone conclusion we are now confronted with a very conscious, reckless monetary nationalism.

The gold currency broke down because one country after another began to disregard the rules. At the same time, the international order crumbled because the prevailing liberal economic order of the last century and the beginning of the 20th century began to give way to a more and more socialist, interventionist or even collectivist order. The new politics killed a currency order which was based on free markets and personal freedom.

The strongest obstacle for the reestablishment of the gold standard is the relatively recent but completely dogmatic faith that this standard is absolutely a thing of the past, in which we could not believe without blushing.

It was therefore highly admirable that your President Reagan had the courage to found his gold commission. Who else

would have had the courage to do it?

We all know the stupid arguments against the gold standard. They are all invalid. No other currency system has offered the world the three important assets of a truly international standard, namely unity, stability and freedom — only the gold standard. No other system came even close to it, not to speak of the present monetary mess.

We now know that the 19th century was a period of prosperity and growth without inflation. Ludwig von Mises wrote in his famous book "Human Action": "The gold standard was the world standard of the age of capitalism, increasing welfare, liberty, and democracy, both political and economic. It was the medium of exchange by means of which Western industrialism and Western capital brought Western civilization into the remotest parts of the earth's surface."

My grandfather, your grandfathers were able to travel without any passports to far away places in the world and pay their hotel bills with just a few gold coins.

Today's monetary chaos keeps increasing the prestige of gold and makes it to the last anchor of safety.

Today, some of you may by contrast remember very well what happened to American tourists abroad only a few years ago when they wanted to pay with greenbacks which were repudiated.

In short: The gold standard of the 19th century was the highest monetary achievement of the civilized world.

By 1914 it was all over. Because of war financing, the tried and tested gold standard was thrown overboard in one night. And it came to the great monetary fall of man insofar as all nations henceforth preferred to eat from the forbidden fruits of inflation and experienced an expulsion out of paradise which was unique in the history of mankind.

Can we reintroduce the international gold standard? I do not believe so at this time and not under the present political and social climate, as the modern mass society with its welfare state is not ready for such discipline. Furthermore, a generation of economists and politicians have become victims of all kinds of dogmas. Both Keynesians and monetarists are vociferous critics, not only of the gold standard, but

also of the use of gold as a monetary base in any form. As a result, there is no chance of a return or monetary renaissance. And this is exactly the reason what makes me so positive for the future of gold in its other important function — gold as a store of value.

2. Gold as a store of value

In its first function — as a base of the worldwide monetary standard — it served just during a relatively short period in history. Its precondition was the liberal world order during the 19th century and the beginning of the 20th century. But in its second and more general function — as a store of value — it served for as long as there is human memory. Throughout history, nobody has loved gold more than the primitive peasants of Europe and Asia. Their philosophy clearly had nothing to do with liberalism. And in the decade of the seventies, history repeated itself and it will repeat itself in the eighties. All official attempts to keep the price of gold down failed miserably. To the contrary, in the last 10 years gold has reached levels that even the keenest optimist did not expect. The reason: More and more individuals have concluded that they can protect their savings only by investing at least a part of it in gold.

The history is full of examples where humans resorted to gold. Every French peasant is reported to have some of his savings in Napoleon gold coins. Their families could thus survive a whole succession of disasters under various forms of governments. Every peasant in the Swiss Engadine mountains has hidden gold Vrenelis under his mattress. Germany is no different. An old friend of mine told me of his experiences: "During World War I Westphalian peasants visited the steel works of my friend's father, the famous Hugo Stinnes, in Dortmund. They wanted to buy horse-shoes for their horses. Yet, their request was turned down because iron was rationed. Not even the offer of the famous Westphalian ham did help. Finally, they offered payment in gold. When they were asked from where they had their gold, they answered that they knew from their ancestors in the Thirty Years' War — some 300 years ago — that: "When nothing bought, gold always bought."

The present situation is not much different. Today's monetary chaos keeps increasing the prestige of gold and makes it the last anchor of safety.

And now, let me give you my ten most important reasons why I am so positive for the outlook of the yellow metal. I believe

that this bull market for gold can continue for a long time, even if it is interrupted from time to time by more or less painful corrections.

1st reason: Fear

Recently gold has boomed because of fear. It has got a "Triple A" myth. The emerging gold bull market in its first stage could therefore be motivated primarily by fear rather than inflation: fear about the debt situation in Poland, Argentina, Mexico, etc., fear about the banking system because the banks have for many years loaned imprudently and are now exposed to all those illiquid debtors, fear about bankruptcies, such as Penn Square, Banco Ambrosiano, and AEG, fear about wars. Since gold cannot default, people are buying it when they are afraid. And reasons for being afraid are multiplying.

2nd reason: Misguided economic, financial and monetary policies

We know that the present situation represents the outgrowth of the abandonment of the gold standard of the 19th century. Today we are living in an era of inflation and inordinacy. John Exter calls it a "non-system", and I agree. The word discipline is a forgotten word. The result of all the misguided policies of the past is a growing monetary pollution, called inflation, or debasement of the currencies. Of course, we have recently seen well-intended, and in many cases honest attempts to fight the cancer of inflation. But the situation has now its own dynamics, and nobody is able to stop it. The road to stability would undoubtedly lead to a severe depression, an economic catastrophe of unbelievable dimensions. And nobody wants to run this risk for one simple reason: In our present day welfare state society everybody is involved. Today, everybody is a creditor and therefore owns some bad debt. In the state bankruptcies and monetary debacles in history, usually only a limited class of people got hurt. For those who lived from hand to mouth (always the majority), these corrections even brought improvements, particularly at the beginning. This time around, everyone is involved because today everybody has savings in some form or another, even if it is just a claim on a pension fund. Thus, the great success of our system might become its curse. For "political reasons" the fronts of our inflation fighters have more than softened.

Furthermore, history has proven over and over again that the authorities in the end always chose to resort to inflating. The former German chancellor Schmidt once said that 5% inflation is preferable to 5%

unemployment. So there exists no fundamental change. All I foresee are higher deficits and expansive monetary policies by central banks.

3rd reason: The world debt situation

The great world inflation has favoured the rise of indebtedness of states, corporations and private individuals. The welfare state and the free lunch system could not be financed otherwise. This is the great tragedy. But it will go on and eventually lead to a catastrophe whose dimensions are unknown to us. Why? Because no private individual or government can extend its

9 REASONS ROTHSCHILD IS BULLISH ON GOLD

- 1) Fear about the debt situation, the banking system and bankruptcies. Since gold cannot default, people are buying it when they are afraid.
- 2) Misguided policies of governments and central banks, growing budget deficits and a chronically expansive monetary policy are inflationary.
- 3) Inflation favours the deterioration of the world debt situation up to the point of no return, therefore gold is attractive because it cannot default. Gold is "AAA".
- 4) Budget deficits, an expansive monetary policy and the world debt situation finally are going to destroy the financial markets. Alternative investment possibilities are shrinking day by day. A big transfer from former alternatives into gold is taking place.
- 5) A collapsing debt structure could lead to deflation. Gold and cash would then represent the best protection.
- 6) In uncertain times, when the economy, financial markets and the tax systems get out of control, the political situation deteriorates as well. Again gold will offer the best protection.
- 7) Gold is getting scarcer and what is becoming scarcer usually increases in price.
- 8) In the war against gold there can only be one winner, namely gold.
- 9) History teaches that gold means freedom.

debt unpunished. In the present stagflation some will not even be able to pay their interest costs. Maybe, the inflating process can be drawn out much longer and the debt might simply be repaid in an inflationary way. The other possibility is the deflationary way. Under both scenarios gold will prove superior to most paper assets as well as other financial assets.

4th reason: The crisis in financial markets

Long periods of inflation create more and more instability in financial markets and make them unattractive. Alternative investment possibilities are decreasing. Common stocks cannot represent sound investments in an unfavourable monetary and economic climate — only speculations.

In addition, the political situation is playing an important role. Germany, economically the most powerful country of Europe, can serve as an example. As long as the Christian Democratic Party was in power, finances were intact. The German CPI increased from 1948 to 1969 by a little over 40% and common stocks by over 500%. Since the coalition of socialists with the FDP is in charge, debt, inflation and unemployment have gone up rapidly. Inflation rose by about 90%, while the stock market during the same period remained flat. As far as bonds are concerned, we know that Dr. Franz Pick calls them certificates of guaranteed confiscation. A bond never had the same purchasing power when it matured as when it was issued.

Because of a lack of alternatives more and more investment funds will be directed into gold.

5th reason: Protection against deflation

There is a serious school that believes that we are heading for a deflation. When states, corporations and banks financially go under, gold becomes even more attractive in their view because (1) gold cannot default and (2) in a deflation central banks will do everything in their power to reflate. "Inflate or die", as Richard Russell calls it, will be the only solution. Remember what President Roosevelt did in 1934. He increased the official price of gold from \$20.67 an ounce to \$35.00. Many gold mining shares went up tenfold. Gold and cash would be the best protection.

6th reason: Insurance in the case of war

In politically uncertain times people traditionally rely on gold. As you know, in recent history we have heard of Vietnam

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refugees who could survive when they owned gold. A good portion of the gold purchases in the Middle East can be ascribed to political unrest in that region. Remember what happened to the price of gold when the Mosque in Mecca was occupied a few years ago. The situation in that area remains a tinderbox.

You might have followed the price of the Argentine Peso before and after the Falklands war. It coincided with the end of the 1980-82 bear market in gold.

7th reason: Gold becomes scarcer

The value of gold is determined by its scarcity. This is perhaps the principal reason why gold became the world's premier monetary commodity.

Largely all the gold that was produced since the dawn of time is still existing. According to Consolidated Gold Fields we are speaking of about 2½ billion ounces. Physically, this would represent a cube of no more than 53 cubic feet which is indeed very little in relation to all the paper money available and being printed every day. As we know, additional gold being newly produced every year amounts to only about 1000 tons. This hypothetical cube therefore is growing by only about 1½% p.a., or about four inches each side.

The reason: Gold production is a very expensive and difficult industrial process, and in order to extract a few grams of the yellow metal it often is necessary to get a ton of rock from several miles below the surface of the earth.

About 50% of these 2.5 billion ounces is in the hands of central banks and they are not likely to part with it. The bulk of the other 50% is mostly in the form of jewelry and works of art. The balance and smallest part exists in the form of coins and bullion for investment purposes. If we consider that most of this again is in firm hands, then there must be a very thin float. A rapidly growing world population, disposing of steadily growing amounts of paper money will push the price of gold to higher and higher levels.

8th reason: The defeat of the Treasury Department against gold and what other central banks are doing

One of the strangest experiences of my career was the desperate fight of the Treasury Dept. (with the help of the IMF) to depress the price of gold by auctioning off the national treasure. Canada is still doing a similar thing. I heard some time ago that

even the Fed's vice chairman, Henry Wallich, called the 1.25 billion ounces in the vaults of the world's central banks "a last ditch reserve". Why then auction it off? This does not make sense to other central banks. To the contrary, they increasingly believe that gold is an important asset. I urge you all to invest your funds in a similar way as the central banks of this world: Hold enough liquidity but buy or increase your "last ditch reserve".

9th reason: Gold means freedom

Gold and free market economy are inseparably related to each other. Gold is the great protector of private property. A high gold reserve makes a country strong: It is more valuable than constantly depreciating foreign exchange. Only weak countries lose gold. And whatever happens in this world, gold will remain the outstanding store of value.

The late Milton Gilbert one day told the following story: "Among my assistants there was a young intelligent Italian. I observed that, each month when he got his salary, he used to buy a gold coin. One day I asked him for his reason. The Italian answered promptly: 'You see, you Americans come to Europe and want to explain to us how to live. I go home and tell my wife: If anything should happen to me or to the banks or the governments, you can take this coin, go to the farmers in the country and you will get enough food for one week'".

In case my arguments could not convince you so far, I would like to tell you a true story:

At the beginning of the World War I in 1914, a Frenchman had 1,000,000 French Francs with which he bought 50,000 Napoleon coins. He did not have to pay income or property taxes. For his expenses for apartment, clothing, food, etc. he spent one Napoleon coin every day. Today, 68 years later he still owns 25,265 Napoleons. Their value today: FF 15,361,000 or more than 15 times the starting capital in 1914.

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BAHAMAS GOLD CONFERENCE

NCMR's Ninth Annual Summer Offshore Conference will be held in Nassau, Bahamas, at Loew's Paradise Island Hotel, June 5 through 9, 1983. It will be the first NCMR Conference ever held exclusively on the precious metals. Featured speakers will include Harry Schultz, Mary Anne Aden, Jerome Smith, Bruno Bandulet (the closest thing to a gnome of Zurich), Gary North, Thomas Main (Chief Economist at the Chamber of Mines) and many others, including top analysts from around the world.

Of special interest will be Sebastian Anthony, the Singapore-based commodity gold trader who has established a remarkable track record of over 50% annualized returns in his gold trading program.

For those investors interested in gold and silver, this could be the best and most important NCMR conference ever. One warning: it's important to register early because of the popularity of the resort and because of strictly limited attendance. For more information, call (504) 456-0040.