

THE OUTLOOK FOR GOLD

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FERDINAND LIPS

Dear Mr. Blanchard - Ladies - Gentlemen !

Last November it was for the first time I was invited to this great conference. I want to tell you that I was very much impressed by the efforts and the success of the organizers and particularly of Mr. Blanchard. Nevertheless, I did not intend to come back so soon because it is not easy to have something dramatically different to say about gold year after year. Still, when I was invited again, I was very pleased and did not hesitate to accept; but it was only a little later that I found out with terror that my story had not changed a bit.

Speaking about the outlook of gold, I would like to remind you that I am a long-term investor. I cannot predict short-term price changes as a number of precious metals advisors and newsletter writers do. As you all know, short-term price changes in the precious metals markets have oftentimes been erratic, dramatic and unpredictable.

For instance, since the lows of June 1982 when there was only gloom and doom bullion prices have gone up 70 %, silver 180 % and the Financial Times Gold Mining index 300 % within seven months. Equally surprising, precious metals markets have undergone relatively dramatic price corrections since February. After climbing to a London a.m. price fixing of \$ 511.50 per ounce on February 15, 1983 the price of gold has dropped to around \$ 400 practically within days. This is still well above June 1982's interim low but market conditions remain highly unsettled, to say the least.

So many trading advisors who "foresaw" prices of \$ 600-650 within days or weeks just a few months ago, suddenly saw much lower levels or even thought that gold is finished.

Ladies and Gentlemen, despite about twenty years of research I have not discovered any scientific method of predicting short-term price changes. After all this time of thinking about gold, writing about gold, investing in gold and living with gold you may understand that this is not the time for me to enter the short-term guessing game.

Also it is not easy for me to talk about "The Rothschild Case for Gold". I am just a member of the management team of the Rothschild Bank in Zurich and I therefore rather prefer to tell you how I see the outlook for gold myself.

Personally I feel that the world is sinking day by day deeper into a financial crisis of historic proportions. We are confronted with the deepest money crisis the world ever faced. It is not only an economic and financial crisis but a moral one as well. The main reason: Since the abandonment of the gold standard all nations of this world have pursued an inflationary policy.

Why has the civilized world chosen this path? First of all because of random accidents but more importantly because after World War I, the Western World was not farsighted enough to return to the true gold standard. Instead the legend was spread that the old monetary order was doomed anyway.

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 historic fact. Secondly: Throughout history gold has been the number one store of value.

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 stabilised 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 supranational 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 and all the satires about the busy digging out of the barbarous relic do not remove the most important fact that human beings do not change.

Why do I begin my speech by talking about the gold standard? Because its abandonment is exactly the reason why I am so bullish about gold. I do not believe in a return to the gold standard and to sound money any time soon. I could see that happening only at the bottom of a deep crisis. I am so bullish about gold because since the abandonment of the gold standard public confidence in their governments keeps declining. Under the gold standard we had an industrial world of steady real growth during six decades before 1914 with rising living standards for the masses and security provided by the protection of savings.

The public attitude towards money has changed fundamentally. Before World War I wars were avoided or terminated when governments did not have the necessary gold to finance military expenditures. Today there are no such monetary restraints, and in order to finance rearmament and the welfare state everybody resorts to credit inflation.

Even John Maynard Keynes in the early 1920s advocated at times the return to gold. He believed that the reintroduction of the gold standard throughout the world would promote better than anything else the revival of trade, production and international credit.

Later on, however, he changed his opinion and as we know from Sir Roy Harrod, he was one of those men who are responsible that we never went back to a true gold standard.

Today we are dealing with a much different situation. In spite of all the technological progress in the 20th century, I can see no progress in the civilization and I can only see retrogression politically, economically, and morally. Because, when the restraints have gone - under the present "non-system", politicians and central bankers resorted to credit expansion.

Since 1961 deficit financing has become a way of life among Western democracies. Financial risk has become a fiscal virtue. In order to force the pace of domestic growth onto re-elections one administration after the other in any country keeps inflating the money supply.

When will this situation end? We have no idea to date, but almost certainly it will not be until the public understands that instead of the present non-system we need a sound foundation of our monetary order. Since this is probably many years away, I am very positive for the future of gold in its other important function - gold as a store of value.

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

And now let me talk to you about my views regarding the outlook of the yellow metal today. I still believe that this bull market for gold has only started and can continue for a long time even if it is interrupted from time to time by more or less painful corrections.

Gold is the best currency

Since the end of the war we had thousands of devaluations. Brazil alone has devalued its money 40 times since the 1st of January 1983. Since the end of Bretton Woods, when the fixed exchange rates system was given up, the world has been suffering under the so-called floating exchange rate "non-system". Although hailed as a great leap forward, it is nothing else than a sure prescription for chaos and economic ruin. Although gold has not done much in \$-terms recently, it has been an excellent performer in most of the other 150 currencies.

Gold is undervalued

There are people who pretend that markets are always right. I do not agree. Markets have always gone from undervaluation to full-valuation and then eventually to overvaluation or vice versa. The difficulty with gold is that you cannot simply apply a price-earnings ratio as in the case of stocks. In my view, gold in the past 20 years has been undervalued most of the time.

First of all because very few people have analysed the long-term inflating process and its investment implications. Secondly most people have been

victims of official propaganda telling them that all is well. In the last years I have seen many important portfolios holding not one ounce of gold. These investors were obviously not well advised. The market capitalization of ASA and of all South African gold mining stocks is only worth a few billion dollars, peanuts compared with a trillion or more of all US stocks. So, who has actually benefitted from the rise of bullion and mining shares. In my view: very few - unfortunately.

More and more investors will realize what is going on

All I can see is that the inflating process has now become firmly established, politically and economically. The result will be continued distortion of international monetary conditions and the individual economies. The impact of such conditions on stock and bond markets is clear and will increase the prestige of gold even more.

As more and more people all over the world are beginning to understand the importance of holding gold as an insurance, this undervaluation will disappear. For that to happen we will not even need a rate of inflation in the dollar of 18 %. 9 % is enough because there will be a much greater number of buyers. It will then be dangerous not to own gold.

The spectre of deflation

1982/83 we came very close to a deflation in the dollar. The debt burden has become so onerous that it cannot be serviced fully any more. The world could therefore fall into a serious economic and financial crisis. In past deflations, many financial assets defaulted and became totally worthless. Gold, on the other hand does not default and can be counted upon to retain its value.

However, for the time being, it seems to me that the FED has done it again.

Economic trends signal renewed inflation

Instead of preparing for deflation, which is a real danger, I feel we will have to worry next about renewed inflation. The inflating process will sooner or later be reflected in renewed price inflation. And, as somebody said: The piper has yet to be paid. As in the past the price of gold will probably reflect this well in advance.

The world debt situation

Governments seem to have chosen the inflationary way to bail out debtors and creditors alike. And do not forget the "Monetary Control Act of 1980".

Governments would rather prefer South American conditions to a deflationary crash. Rather than tolerating a banking collapse everybody tries to keep the money illusion alive by rescheduling maturing debt. But as the President of the Deutsche Bank, Mr. Guth, has said, rescheduling must be learnt.

Whatever the outcome will be, the best protection would then be gold - preferably in Switzerland.

Furthermore, all the unknowns about the debt crisis are likely to create fear. You remember what happened to the metal in the summer 1982 when the Mexican crisis broke out in the open. Such fear will prevail for many years to come and increase the interest in gold as an insurance.

The negative long-term damage that inflation causes in financial markets

The inflating process of the last 20 years not only caused more and more turmoil in the monetary environment, but also growing government interference in the marketplace. Most common stocks and bonds have therefore proved to be unsatisfactory investments most of the time, as portfolios were ravaged by sometimes dramatic market declines and loss of purchasing power. Both the Reagan and Thatcher governments who started with great promises, have not been able to stop the trend towards more government and therefore to more politically induced inflating. The outlook for these markets is therefore not good. Nevertheless, the nimble trader may reap from time to time sizeable profits when the timing is right. But those among you who remember Graham & Dodd know the difference between investing during the days of sound money and today where there is only one theory left - namely the "Greater fool theory". As investors are disappointed by the traditional vehicles, they move to gold.

Insurance in politically uncertain times

The long-term inflating process is taking away wealth from almost all citizens. This process is so harmful because it undermines confidence in our institutions and poisons our society. Most people do not even realize the harmful effect of this insidious development on our civilization. They may just feel that something is wrong with our time but they don't know what it is. The one's who understand have always protected themselves by resorting to gold. You don't need wars to make people interested in gold. Look

again at France where socialist management is leading to even more rapid currency debasement than in the past. Can you imagine, how happy all these farsighted French are now with their gold Napoleons? Certainly much more than with their heavily taxed real estate.

Remonetization or increased use of gold as a collateral

There has been talk that poorer governments have been selling gold in 1983 in order to meet debt payments. However, many central banks are valuing their gold at market related prices and have a vested interest that the market price of gold does not drop too far. So some countries such as Portugal have made increased use of collateralizing gold for loans from the BIS. Others such as France, Italy or Eastern Bloc countries could follow. Sales by some central banks could have a negative impact short-term, but would be positive for the gold price longer-term. The reason: when the poor countries run out of gold they have to be supported by the stronger nations. On balance, I feel, however, that central banks will be buyers. Just remember that, when Nixon closed the Gold Window, it was not because his government felt, it was just another commodity. But it was simply too precious to give it away to the French or the Swiss.

Scarcity of gold

The economic recovery underway will continue to bring rising demand for gold. Look at the very strong performance of platinum and palladium with their more important industrial use. - With a better economy we can also expect a higher demand for jewelry purposes. That would mean less gold is available for the private investment demand, according to estimates only about 8.4 million ounces.

Ladies and Gentlemen, assuming that the cycle is right, then this is very little gold, particularly if some new buyers are interested.

And the cycle is right

Continued monetary ease on the part of central banks with all its consequences will result in increased interest in gold.

At the present time gold still has to compete with booming stock markets throughout the world and very high interest rates in the dollar. But as the stock markets become overvalued and investors are beginning to realize that the dollar is no virgin, things will change.

We live in uncertain times. The financial markets have become casinos. Currencies and interest rates are fluctuating to a degree that was once unthinkable. There is no more standard of value left. Nobody can think of investing in stocks and bonds for the long-term and forget about. So there is gold. Gold, of course has, as everything has, a price risk, but gold cannot default and will always retain its value. For this reason we of the Rothschild Bank in Zurich always invest a certain percentage of our portfolios in gold.

So what is my investment advice regarding gold today? I think gold should be hoarded. Gold has to be regarded as your insurance. Do just what the central banks of this world are doing: Hold gold and enough prime liquidity. The central banks don't hold venture capital, they hold gold. Neither do they know whether gold goes first to \$ 300 or to \$ 450.

Some may argue that the purchasing power of gold in terms of all commodities is still high or that the big move which carried gold from \$ 35 to 800 will not be repeated next week or next month. But as long as the world's monetary, economic and political instability persists gold will help you to preserve your assets. Don't think short-term, think long-term, think like the Swiss National Bank.

Before closing let me repeat some historical experiences of mankind. You can be sure what was valid 3000 years ago will be valid 3000 years from now.

It is well known that gold was an important stabilizer in ancient Egypt, Greece and Rome. Particularly East Rome was on a gold standard, the solidus for almost a thousand years.

But it is not as well known that in the Holy Scripture of India there is a passage saying that in revolutionary times ordinary money loses its value and only gold keeps its purchasing power.

In the year 1848 Karl Marx was hoping for a revolution. In 1849 he published a statement in which he pretended that the gold rush of California saved capitalism.

But one of the most beautiful passages that I came across in the last few years, is contained in the "Codex Boranus" of the Abbey of Beuron in Southern Germany:

"The mightiest ruler cannot become mightier than gold. Even the pride of Kings and the Elected humbles themselves before gold."

Thank you!