



MAIN TOPICS

- Government bonds and major currencies attract investor funds
- Fiat currencies have no intrinsic value
- Monetary expansion will ultimately lead to the debasement of currencies
- Gold is one of the best ways to preserve wealth

Rand Refinery Weekly Gold Commentary

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While global markets drift sideways as they wait some signal to indicate the recession is over, investors have plowed some of their funds into government bonds and strong currencies. Yet, investing in both these instruments is not risk free and many Treasury bonds are at record low-interest rates. Bond investors evidently believe that the chances of inflation are next to zero and that the single safest place to be is in US Treasuries. Investing in currencies can pay handsome dividends but in today's current economic climate and with so much uncertainty the value of your funds can change dramatically overnight.

Over the last few years we have seen extreme volatility in the currency market as governments continue to debase their currencies with their monetary expansionary policies. If you have held money in US dollars, the value of your funds has lost over 30% in less than 10 years. Now, with global interest rates at almost zero in some instances, investors who were once relying on the interest for income have now got to rely on using the capital. In times like this it is essential to understand the dynamics of these markets and thus be able to make a correct choice in order to preserve one's wealth.

All these currencies are known as fiat currencies. A fiat currency is a medium of exchange composed of some intrinsically valueless substance which the issuer does not promise to redeem in a commodity or a fiduciary money. And, because a fiat currency has no direct legal connection to a commodity money (in terms of redemption) and, therefore, no real economic cost to its production, the supply of a fiat money can never be self-limiting; and the value of a fiat money is always largely a matter of public confidence in the economic or political stability of the issuer.

Massive currency devaluations can cause the collapse of an entire economy

every major fiat currency has self-destructed in what is popularly called "hyperinflation" (that is, extreme decreases in purchasing-power) caused by either unlimited increases in the supply of that fiat money by the issuer or accelerating loss of public confidence in the continued value of the money or the economic or political fortunes of its issuer, or both. Every fiat currency since the Romans first began the practice in the first century has ended in devaluation and eventual collapse, of not only the currency, but of the economy that housed the fiat currency as well.

Post-World War I Weimar Germany was one of the greatest periods of hyperinflation that ever existed. The sums of money to be paid by Germany were enormous, and the only way it could make repayment was by running the printing press. Inflation got so bad in this period that German citizens were literally using stacks of marks to heat their furnaces.

In April 1919, one US dollar would have bought twelve marks. And, by October 1923 one US dollar would have bought 25.26 billion marks and two months later 4.2 trillion marks. Other examples of fiat failures include Argentina. In 1932, Argentina had the eighth largest economy in the world before its currency collapsed. In 1992, Finland, Italy, and Norway had currency shocks that spread through Europe. Then, in 1994, Mexico went through the infamous "Tequila Hangover," which sent the peso tumbling and spread economic hardships throughout Latin America. In 1997, the Thai baht fell through the floor and the effects spread to Malaysia, the Philippines, Indonesia, Hong Kong, and South Korea. The most recent case of total monetary collapse and hyperinflation occurred just over our borders in Zimbabwe where due to total government mismanagement, the Zimbabwe dollar ended up by becoming worth less than the value of the paper it was printed on.

While we can hardly compare the United States or any country in the Eurozone with Zimbabwe, with sovereign debt around the world exploding, governments are going to be forced to print more money to fund these massive debts. And, as history has shown us, this system of paper money (fiat money) always fails. The reason paper money systems always fail is because they provide no practical limit to credit. New currency reserves can always be printed. Bad debts are funded with more debt. This ability to simply manufacture money will continue as long as there remains confidence in the system. Unfortunately, at some point, the debts become so large the whole system simply collapses and all that paper money becomes worthless.

In most cases, a fiat monetary system comes into existence as a result of excessive government (public) debt. The last time this happened in the US was in the 70's when Nixon abolished the gold standard, and thereby removing any intrinsic value to the US dollar. And, in 1973 the IMF officially abolished gold as part of the monetary system. One of the problems of having a currency backed by gold is that this system restricts monetary expansion and as a consequence restricts economic growth. But, at the same time, the only thing that gives a fiat currency its value is its relative scarcity and the faith placed in it by the people who use it.

Unlike fiat currencies, gold has an intrinsic value

If we look at the dilemma governments are currently experiencing, in particular massive national debt, low economic growth and high unemployment, these issues are precisely the issues that can cause a fiat currency to falter and eventually collapse. So, while governments and central banks try to avoid such a scenario, owning gold should be a cornerstone investment in everyone's portfolio. Unlike paper money, it is tangible, indestructible, and it is the only financial asset that isn't someone else's liability. Furthermore it is extremely liquid and, unlike property, it is also portable and can be converted into cash practically anywhere in the world.

While the price of gold is influenced by many different factors, right now it is being sought out as a hedge against the declining values of these fiat currencies. It is not a new phenomenon and historically it has always been known as an effective way to preserve wealth in such times. So, as global currencies continue their downward slide expect gold to trade much higher.

The current economic scenario is frightening and if you simply choose to ignore it, you will be financially destroyed over the next several years. And, the only way to protect yourself against this trend is to hold real assets including metallic money such as gold.

TECHNICAL ANALYSIS



The price of gold has been very robust since its previous lows made in July. During last week the price of the yellow metal traded a tad over \$1240/oz a mere \$25 an ounce away from its historical highs. Before the price of gold sets a new historic high, we first need to see it break through the key resistance levels of \$1240 (R1) and then \$1260 (R2).



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