

Gold vs. Paper Money

Beigesteuert von Lars Schall
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Egon von Greyerz, Managing Partner of Matterhorn Asset Management AG in Switzerland, is known for his clear cut analysis on worldwide financial developments. His message: "The Dark Years Are Here." In an exclusive interview for MMnews, Mr. von Greyerz reflects on hyperinflation, the end of the "US empire" and his expectations related to the gold market.

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Mr. von Greyerz,
recently I did an interview with investment manager Marshall Auerback and asked him about his position on hyperinflation in the United States.[1] You have read his answer to that question. What are your thoughts on his arguments related to this topic and why do you have a fundamental different opinion than Mr. Auerback?

Virtually without exception, hyperinflation arises as a result of a collapse of the currency. It does not stem from demand pull or costs running out of control.

The prerequisites for hyperinflation are a deflationary or non-inflationary recession/depression leading to major government deficits. The government issues debt paper to finance the deficits. Initially investors continue to buy the government bonds especially as in the case of the US with the dollar being a reserve currency. This is the first stage of the money printing cycle.

Then foreign investors stop buying the bonds and the government has to buy their own paper. This is the second stage of the money printing cycle which is called quantitative easing (a nonsensical fancy word for money printing).

As the money printing accelerates due to growing deficits, foreigners will no longer buy the worthless paper and the currency begins to fall. This leads to a vicious circle of a falling currency, more money printing, inflation and finally hyperinflation. I realise that this is simplified version of the course of events leading to hyperinflation but I believe in explaining things so that most people can understand.

In my view the quantitative easing will now accelerate both in the UK and the US. Unemployment is going up in both countries. Real unemployment in the US is over 20% which is 30 million people. With dependents there are now 100 million people in the US affected by unemployment.

In the UK real unemployment including benefit seekers is 17% or 6.4 million. Including dependents there are 20 million people affected by unemployment. That means that both in the US and in the UK there around 1/3 of the population is affected by unemployment and the numbers are getting bigger daily. This is an untenable situation.

The next area which will necessitate acceleration in money printing this autumn is the financial system. None of the problems in the banks or the financial system have been solved in the last 12-18 months. They have just been swept under the carpet. The toxic debt situation is still critical. A big percentage of the \$1 quadrillion derivatives is worthless.

The lower figure, circa \$500 trillion, of outstanding derivatives published by the BIS is just another "adjustment" in order to massage the figures. Other major problem areas in the US are Option A and Alt A mortgages. This could be a bigger problem than sub-prime. Then we have commercial real estate, personal credit, car loans, etc. Most of these loans were raised in good times and there is no chance whatsoever that they will be repaid in bad times. The average American is one pay check from bankruptcy. The UK is in a similar position.

My strong opinion is that the US dollar and the UK pound are going to very weak this autumn. This is the beginning of the hyperinflationary stage which will later spread to many countries.

What effects would an hyperinflation in the United States have for the global economy? And could you put it in the bigger picture related to the "US empire"?

There won't be hyperinflation only in the US but also in the UK as I have just mentioned and in many Eastern European countries as well as the Baltic States. If Ireland were not in the Euro zone they would also have the same problem.

The US, UK and some other countries will have a hyperinflationary depression, but most other countries in the world will have at least severe recessions but many also depressions. There is total interdependence in the world today both in the financial system and trade.

The cause of the problems in the US and UK is the credit bubble and the leveraged financial system. So far almost 100 banks in the US have collapsed this year. The FDIC has run out of money and the government will have to print massive amounts in coming months to fund the FDIC. But until now only small banks have gone under, except for Lehman, but I would expect bigger banks to have major problems again in the next 6-12 months.

I believe that there is a high risk that more than one major US bank will come under severe pressure during this period. The US Government might be able to save one major bank but not two. And since the problem is across the board in virtually all banks it will not stop with one. Take JP Morgan Chase which has almost \$100 trillion in derivatives. In case of default it is the gross amount of derivatives that is exposed

When the world's biggest economy collapses, this will have a major effect on the rest of the world. US imports and world trade in general will drop dramatically and a worldwide depression would be a virtual certainty. There is also a high probability that the world financial system does not survive in its present form.

There is a limit to money printing and we have practically reached that limit. Greenspan was totally incompetent as Chairman of the Fed and so is Bernanke. There was only one solution to every problem – flood the market with liquidity and make money free. The bankers prospered, politicians loved it since their voters thought that they were prosperous. Little did the people understand that their prosperity was false and based on credit. There has been collusive back scratching between politicians and bankers with both sides benefiting enormously from the credit bubble and money printing. Power and greed runs the US economy and many others.

When will politicians ever learn that money printing only serves the purpose of keeping them in power for a short while whilst it totally destroys the economy and money? Voltaire said already in 1729 that "Paper money eventually returns to its intrinsic value – ZERO". No paper money has ever survived in its original form and the dollar as well as most other currencies will not survive this time either.

It would be a lot better for the world in the long term that we have a proper forest fire so that all the weak growth disappeared and that the forest or the world financial system started again from a sound base. No politician would be so brave as to let the banks fail because with the massively inflated financial system we have today, the consequences will be catastrophic. But sadly it is likely to happen anyway and an uncontrollable collapse of the world financial system is likely to take place within the next few years and change the world as we know it today.

As regards the US empire, it is already finished. Very few nations have any respect for the US financially or politically. The US is conducting its affairs just like the Emperor who had no clothes. They are bankrupt financially and intellectually but they still believe that they are ruling the world. Don't get me wrong, I love America and the American people but their country is in dire straits once the current crisis has settled, and it could take at least 20 years as I said in my Newsletter "The Dark Years Are Here". It could also take longer. Remember that the Dark Ages lasted for 500 years.

What advantages does gold possess that the US-Dollar doesn't have?

Recall the Voltaire statement:

“Paper Money eventually returns to its intrinsic value — ZERO.” In the past governments at least had to print the paper to create money but now in our electronic world, all they need to do is to press a button. The temptation for governments throughout history to print money to stay in power has always been too great.

Gold has been money for 5,000 years whilst no paper money has ever survived. Gold can't be printed and has no debt attached to it. Gold is not one country's currency and can't be manipulated, except for in the short term. Also gold is a store of wealth and is indestructible. Virtually all gold ever produced still exists. Gold has a very high value to weight ratio. All the gold ever produced will fit into a 20 meter cube.

Also gold has limited supply. World annual production is around 2,500 tons and declining. This means that only \$80 billion of new gold is produced every year which is miniscule in today's financial markets. There is only about \$800 billion of investment gold held privately currently. This is only 0.5% of world financial assets. Central banks worldwide are now net buyers with China and Russia buying whatever they can lay their hands on without pushing the price up too fast.

I have been forecasting for some time that the next phase in the gold price rise would start in the autumn of 2009. We are around \$1,000 now and I see a rapid rise from here. Virtually no average investor or fund holds gold today. This will change very soon. But investors are not going to trust paper gold in the future but will want physical gold. With a limited supply rapidly increasing demand for gold can only be satisfied at much higher prices and they are coming very soon.

In my view, there is only one way to buy gold. It has to be physical and it must be under your own personal control, stored outside the banking system. This is what Matterhorn Asset Management and our division GoldSwitzerland do for investors.

One of your recent newsletters for “Matterhorn Asset Management” was titled “The Dark Years Are Here”.[2] Can you let us know what will happen in the near foreseeable future besides inflationary developments that make you think we're about to enter dark years?

Unemployment will continue to increase worldwide. Government deficits will escalate with revenues declining and expenditure soaring. The toxic loans and derivatives in the financial system will never be repaid. Because of these massive problems the recession will lead to depression and then hyperinflation.

Eventually hyperinflation ends in deflationary collapse. With the financial system likely to collapse life will not be the same in the world for a very long time. Law and order will be virtually impossible to maintain so there will be social disorder and major increase in crime. There will be anarchy in many countries. There will be food shortages and extreme poverty. There will be wars. The world will not be the same for a very long time.

But there is always a positive side to every problem. The family will again become the kernel of society. Today's

society which is based on material values and instant gratification will disappear and so will the golden calf. Instead soundly grounded ethical and moral values will return, built around family and close friends.

One of the reasons why the gold price is rising is in fact because inflationary tendencies are feared. On the 7th of September, the price jumped for the first time (since February of this year) over the “magical” number of US\$1000 per ounce. Will it rise furthermore? If it fails to do it, experts say “we could see a sharp decline in bullion and precious metals mining stocks. Put simply, if the price of gold fails to climb past US\$1,000 per ounce and instead, it falls below US\$920 per ounce, it will be a negative omen.”[3]

Gold will not fail to go up from here. If there has ever been a clear investment situation, this is it. A financial system built on quicksand will see to that. Also, hyperinflation and money printing will see to that. Some people ask, what about if we get a deflationary collapse instead, won’t gold go down then?

I see the probability of a deflationary collapse as very low. Governments will not stop the printing presses. But even if I were wrong and we get a deflationary collapse, gold is still the best protection.

Because in a deflationary collapse there is absolutely no chance whatsoever that the banking system will survive. No loans or derivatives could ever be repaid in a deflationary asset implosion. This is why gold is a win-win situation whether we get inflation or deflation.

Since 2002, “Matterhorn” advised its investors to put up to 50 percent of their liquid assets in physical gold. That’s quite unusual. Why 50 percent? And moreover, which elements should a wealth preservation portfolio a) contain, and b) not contain in these times of crisis?

It was very simple. Gold was ridiculously cheap at \$300 when we advised investors to put 50% of their assets in the yellow metal. Already back in those days we forecast that the housing and credit bubbles would lead to major problems in the banking system and inflation/hyperinflation.

For the investors who followed our advice the 50% of their liquid assets in physical gold has become over 80% after gold has appreciated more than three times. We now feel very comfortable with 80% in physical gold. A smaller percentage of that could be in silver. Silver has more potential than gold to appreciate but it is very volatile. I believe that 10-15% could be in precious metals mining stocks.

There is enormous potential in these stocks but the problem is that it is not wealth preservation. If something happens to the financial system, investors might not get access to their stocks for years. Also there is the risk of nationalization of mines or punitive taxation when precious metals prices surge.

Stocks might go up in a hyperinflationary scenario but not in real terms. The Dow and most world stock markets are down over 80% against gold in the last 10 years. I

expect another 90% fall at least of the Dow against gold. I would definitively not recommend government bonds or any other bonds. Investors are unlikely to be repaid in normal money and bond prices will collapse as interest rates go up.

There are many ways to invest in gold. At "Matterhorn" you do not offer everything you could. Why do you exclude certain things and why do you recommend to store gold outside the banking system?

Physical gold held in your own name and stored safely outside the banking system is the only true form of wealth preservation.

Virtually every other form of gold is paper gold. Many ETF's don't hold physical gold and even if they do, all you have is a piece of paper which is of no use if the banking system collapses. I would not store the gold in a bank due to the risk of the banking system failing.

And storing gold at home is definitively not a good idea. With the increase in crime in the next few years, this is very risky. There are two major and very good companies that sell gold on the internet and store it outside the banking system. But you don't own your own gold bars but fractions of a 400 oz bar. If something happens to the financial system you cannot go and collect your gold bar to pay your expenses.

There is clearly no absolute method of wealth preservation that protects investors against all eventualities. But it is vital to have a plan that gives the best available level of protection for peace of mind.

On September 3rd, Hong-Kong recalled all its physical gold holdings from depositories in London.[4] What are your thoughts on this?

I think they are right. You should have your own gold under your own control. There is so much lending of gold taking place between central banks that there might not be any gold left at the end.

As you know there are rumors for years that Germany's gold reserves are not located in Germany but in New York. Let's assume this is the case: wouldn't now be the perfect time to order them back? And if it was the case that the total amount of Germany's gold holdings were stored in the vaults of the Federal Reserve of New York — why should this be of interest to the German population?

Yes, and for the same reason that Hong Kong took its gold back, I think Germany should. Firstly, only then do they know if the gold still exists and secondly I wouldn't want another nation to control my gold, especially not a bankrupt nation.

One last question, Mr. von Greyerz. You are familiar with the claims of the Gold Anti-Trust Action Committee (GATA), that the gold market is rigged by "the Gold Cartel" in order to suppress the price of gold.[5] Do you follow the

activity of Bill Murphy and his camp with particular sympathies?

Yes, I am very familiar with GATA and their activities. I am convinced that the gold market is rigged (as well as the silver market) and Bill Murphy and GATA have done a great job in trying to break the gold cartel. My view is that very soon paper gold manipulation will be ineffective and only physical gold will count. The world will then find out that a lot of central bank gold has been lent out and there will be major discrepancies in physical gold. This will lead to audits of central bank gold by new governments since the existing ones are part of the cartel. I am sure that we will then find out that there is lots of gold missing or double counted. The result of this will have a major impact on the gold price.

Thank you for taking your time, Mr. von Greyerz!

SOURCES:

[1] compare Lars

Schall: "Marshall Auerback: 'Many years of economic stagnation'", published September 7, 2009 at: <http://www.mmnews.de/index.php/200909063709/Rohstoffe/Marshall-Auerback-Many-years-of-economic-stagnation.html>

As a matter of accuracy it should be pointed out that Mr. Auerback does not share the opinion that a "Weimar-style hyperinflation" has to be expected for the United States. He is well aware that inflationary monetary policies are in general on the Federal Reserve's agenda: "Bernanke has to continue to make hawkish comments about inflation so as to avoid a complete blow out in bond yields, but the dirty little secret is that inflation is the way out of the debt trap, along with dollar weakness. Both reduce the real cost of debt servicing." Marshall Auerback: "Inflation: The strategy that dare not state its name", published May 8, 2009 at:

<http://www.creditwritedowns.com/2009/05/inflation-the-strategy-that-dare-not-state-its-name.htm>

[2] Egon von Greyerz: "The Dark Years Are Here", published June 4, 2009 at:

<http://matterhornassetmanagement.com/newsletter/?newsletter=20>

[3] Puru Saxena: "Big Move

Coming", published September 03, 2009 at: <http://www.financialsense.com/editorials/saxena/2009/0903.html>

[4]

Chris Oliver: "Hong Kong recalls gold reserves, touts high-security vault", published September 3, 2009 at: www.marketwatch.com/story/hong-kong-recalls-gold-reserves-from-london-2009-09-03

[5] compare Lars

Schall: "Gold-Manipulation: 'They are about to hit the wall'", Interview with Bill Murphy published August 31, 2009 at: <http://www.mmnews.de/index.php/200908313669/Gold-Silber/Gold-Manipulation.html>.

See for further information GATA's website www.gata.org

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