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18th October 2010

Bubblicious

"I hate journalists. There is nothing in them but tittering, jeering emptiness. They have all made what Dante calls the Great Refusal. The shallowest people on the ridge of the earth."

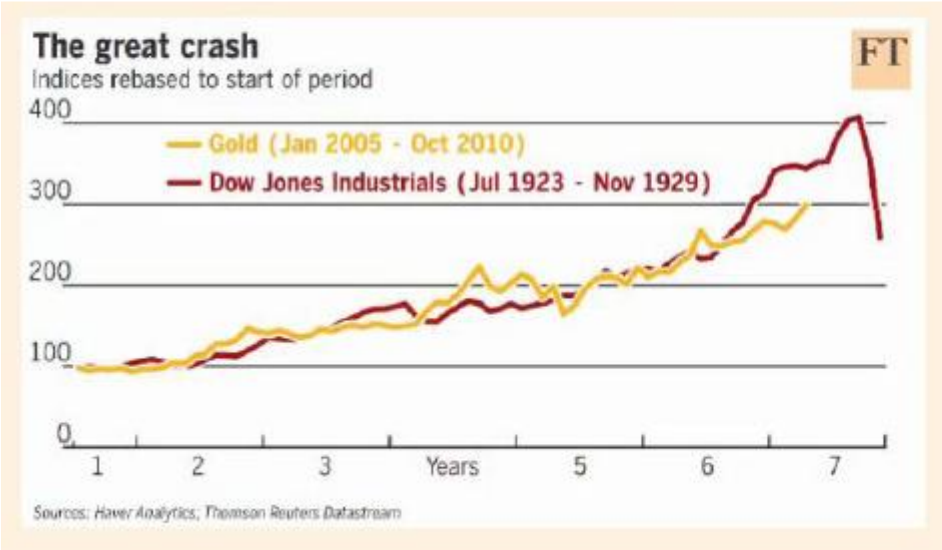
- William Butler Yeats.

For a pink paper, one might have thought that the Financial Times would have greater affinity with a yellow metal, but no – its long, tiresome antipathy towards gold staggers on. (If and when the FT ever turns positive on gold, we will know that the high is close at hand.) The latest manifestation of its auric antagonism is James Mackintosh's 'Short View' of 14th October, in which he

"compares gold's climb to other market bubbles"..

Note that reference to "other.. bubbles" as if gold's steady appreciation – merely the flip side of a fast devaluing dollar – was a case-closed proven example of what the OED refers to as "anything fragile, unsubstantial, empty or worthless.. often applied to delusive commercial or financial schemes." That sounds a lot more like the global fiat monetary system or like fractional reserve banking than this innocent metal that has outlived every paper currency as a store of value for the past few thousand years. But then the reality is that there are still plenty of people who simply don't ***get*** it – which is another reason to think that the "bubble" in gold (and silver) still has plenty of scope for further, erm, ***inflation.***

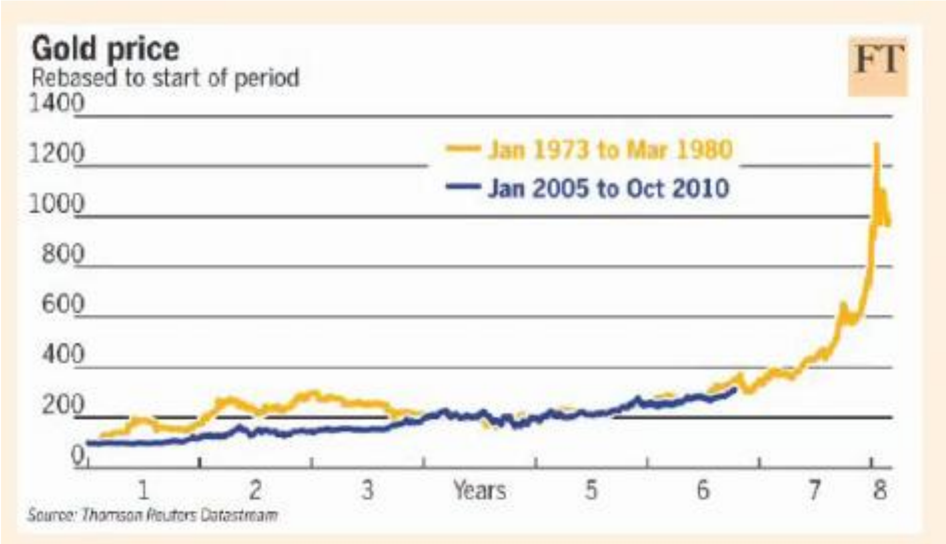
Mackintosh deploys some nifty chartist legerdemain, overlaying the recent price history of gold against previous bubble outbreaks, such as that of the Roaring Twenties:



Or 1980s Japan:

Or 1990s Nasdaq:

Or gold itself (look out – gold looks like gold !), during the 1970s:



One might almost call this yellow journalism (biased opinion masquerading as objective fact). Selective comparisons with prior bubbles are just that – selective. One might just as reasonably overlay the price of gold with the price of the FT itself, which has doubled since 2007, or with the price of an online subscription, which in just over three years has risen from £65 to more than £170. Is the FT a bubble ?

The harsh reality is that with most western governments raping their own currencies in a quite possibly futile race to the bottom, and with QE2 steaming towards port, driving up asset prices almost indiscriminately, the business of objective investment analysis is almost impossible – a practically existential crisis for any asset manager who takes his job seriously.

As management consultant Andreas Acavalos puts it,

"..the problem of economic calculation under a fiat money regime is fundamentally insoluble. It cannot be solved for exactly the same reason that you cannot solve the problem of "measuring" a length of cloth with an elastic tape measure. The only "solution" is to throw away the elastic and use a yardstick that cannot be stretched at will.

"Since it is unfortunately not within our power, as ordinary citizens, to do away with fiat money, we have to live with it and manage our affairs accordingly; we must, in other words, take rational economic decisions in the context of an irrational monetary regime that distorts relative prices and renders them increasingly meaningless as guides of where to invest.

"Here, I think, is where the role of gold comes in: acquiring gold is not an investment. It is a conscious decision to REFRAIN from investing until an honest monetary regime makes rational calculation of relative asset prices possible. In this sense, gold plays a quintessentially monetary role: it permits you to postpone your investment decisions and to keep your options open for future investment. As awareness of this function of gold (and silver) increases, its price relative to other assets (including fiat currencies) rises. This is what we have witnessed over the last several years."

And yes, of course, the price of gold could easily retrace some of its recent gains. But for gold and silver prices to collapse (or for these supposed bubbles to "burst") would require a sudden and hugely unlikely rediscovery of mass fiscal and monetary credibility on the part of G7 governments who are currently slashing at the value of their own paper currencies like Freddie Krueger, perpetuating the already overly long Nightmare on Wall Street.

I am grateful to TD's Jonathan Escott for sharing the following FT editorial dating back to April 2004, at which point the gold price was $400 an ounce. Selected highlights for those who appreciate their irony served full-fat include:

"For private investors to hold gold.. is their own foolish affair.. holding gold is irrational in the first place.."

FT EDITORIAL APRIL 16th 2004 PRICE $400.65

Going, going, gold

The pointlessness of holding bullion continues to sink in

The barbarous relic, as Keynes called it, is crumbling to dust. When even the venerable NM Rothschild has quit the gold market and the Bank of France, among the most stubborn of the official goldbugs, is thinking again about its bullion holdings, the end of gold as an investment has come a little closer.

It will not be before time. The fetishisation of shiny yellow metal, decades after it ceased to be used as the anchor of the international monetary system, is a lingering anomaly in modern financial markets. Perhaps Rothschild's last service to the bullion market could be to keep a live gold trader on display behind glass as a reminder of a bygone age, like the former coal miners who now make a living giving tours of defunct pits.

The one advantage of gold as a reserve asset is that, unlike assets based on fiat money, governments cannot make it worthless by inflating it away. But in an era of low inflation, and given that independent inflation-targeting central banks are the norm across the industrialised world, that risk has very sharply diminished.

Indeed, for both private and official investors, gold is now a rather risky asset with a nil or low return. The intrinsic value of gold, determined by its use in various industrial processes, is well below its market price. Gold does not grow. So its value to any one investor as an asset is dependent on other investors also holding it as an investment asset. The gold price hangs precariously by its own bootstraps.

For private investors to hold gold on this basis is their own foolish affair. For central banks and governments to hold it as a reserve asset is a betrayal of the public on whose behalf they are acting. Despite recent sell-offs, governments and central banks still hold about a fifth of the world's bullion. Their large holdings relative to the size of the market by themselves make gold particularly ineffective as a reserve asset: the very act of official selling of bullion on any large scale to raise cash will itself drive down the price.

This danger was amply demonstrated by the UK's unhappy experience of trying to sell some of its gold holdings. Announced in 1999 in a sensibly open and transparent fashion, the sales sparked such a fall in the global bullion price that a group of central banks signed a concord limiting such sales. That has recently been superseded by a new agreement providing for limited official sales.

Given the pointlessness of holding gold, the speed of its official sell-off scarcely matters, unless leaching the gold into the market bit by bit somehow maximises the return to the public purse by limiting the impact on the price. That would imply some irrationality on the part of the market. But then holding gold is irrational in the first place. Perhaps the central banks are right to go slowly.

Whatever the speed, the direction is clear. Gold is on its way out as an investment and a reserve asset. Three cheers for that.

As irrational as taking unsolicited and thus far catastrophically vile investment advice from financial journalists ?

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18th October 2010.

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