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The Scourge of the Faith-Based Paper Dollar

Jim Grant foresees a new American gold standard despite Wall Street's stake

By **HOLMAN W. JENKINS, JR.**

Jim Grant's father pursued a varied career, including studying the timpani. He even played for a while with the Pittsburgh Symphony. But the day came when he rethought his career choice. "For the Flying Dutchman overture," says his son, "they had him cranking a wind machine."

The younger Mr. Grant, who can be sardonic about his own chosen profession, might say he's spent the past 28 years cranking a wind machine, though it would be a grossly unjust characterization. Mr. Grant is founder and writer of Grant's Interest Rate Observer, perhaps the most iconic of the Wall Street newsletters. He is also one of Wall Street's strongest advocates of the gold standard, knowing full well it would take away much of Wall Street's fun.

You might say that, as a journalist and historian of finance, he has been in training his whole life for times like ours—in which the monetary disorders he has so astutely chronicled are reaching a crescendo. The abiding interest of Grant's, both man and newsletter, has been the question of value, and how to know it. "Kids today talk about beer goggles—an especially sympathetic state of perception with regard to a member of the opposite sex," he says of our current market environment. "We collectively wear interest-rate goggles because we see market values through the prism of zero-percent funding costs. Everything is distorted."

He adds: "I can't explain the world's infatuation with government securities and negligible yields. These bonds and notes and bills are denominated in currencies that central bankers are doing their best to depreciate."

By "can't explain," he perhaps means he recognizes too well a phenomenon he can't justify. The famously lanky Mr. Grant, whom I meet in his office over Wall Street, is a dyed-in-the-wool skeptic of the efficient markets hypothesis. Markets are "unpredictably inefficient," he says. Right now, he sees Ben Bernanke's Federal Reserve as a prime malefactor behind the characteristic economic folly of our age (though China is a big offender too): suppressing the proper functioning of the price system. "By flooding the system with dollar bills, I submit to you that he has accomplished little of what he meant to accomplish and he has unintentionally done a great many things he didn't want to do."

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Mr. Grant is also a critic—albeit with caveats—of today's great bankers, whom he says in one respect don't hold a candle to their gilded forebears. "When you take away the downside, you take away the virtue. You take away the moral foundation of markets. You always have envy but now the envy is a little better grounded in objective facts. Taxpayers get the downside. Modern-day Wall Street gets the upside."

The upside did not come swiftly for Mr. Grant, a veteran of our sister publication Barron's, where he was the founding author of its "Current Yield" column. He left the comfy arms of Dow Jones in response to an "intramural political squabble" and, in 1983, hung out his own shingle.

Upon plowing his $75,000 in accumulated Dow Jones profit-sharing into a newsletter, he expected his former Barron's readers to race to sign up. They didn't. His nest egg quickly evaporated. Paying himself a salary was not even on the agenda for several years. Eventually he took on a silent partner in Wall Street investor John Holman Jr., whose children now luxuriate in dividends from Grant's Interest Rate Observer.

"The tax problems were long in coming," Mr. Grant notes wryly. Come they did. Today, he will only say that his subscribers number between 5,000 and 10,000. At $910 a pop, you do the math. Mr. Grant hosts three sold-out conferences a year in New York and London and is interviewed frequently on television. ("Business development," he calls it.) Along the way he's also written several books of financial and political history, including 1992's acclaimed history of debt, "Money of the Mind."

Not bad for a kid who, technically, never got off his native Long Island, since he and his wife, a doctor, today live in Brooklyn, where they raised four children. One of those children recently earned a place in the record books as a victim/beneficiary of long-range yenta action: Two mothers meet by chance in the old neighborhood. It turns out both have young Marines serving in Fallujah. The result is stated succinctly in a New York Times wedding announcement last October: "Emily Hope Grant and Matthew Demetri Turner, both Marine captains, are to be married Sunday in Brooklyn."

Perhaps even more delightful for the father, his daughter is no longer in Fallujah. She starts a new job on Wall Street next month.

Of his own Wall Street clients, Mr. Grant says, they seem to renew at "gratifying rates," his best indication that he's doing something right—i.e., making them money. He freely admits to a lack of market clairvoyance. What Grant's can do for its readers, he says, is observe how the market is handicapping future outcomes and call attention to cases where it thinks the odds look out of whack. When Treasury bonds were yielding 13% in the early 1980s, Grant's called them a screaming buy. If inflation, then coming down, suddenly ran amok again, an investor could give up 13% a year in principle and still break even on the coupon.

Likewise, before the housing crash, he took a hard look at subprime mortgage securities and urged investors to short them. "They were then selling at 100 cents on the dollar," he now says. "If we were wrong, they might go to 101 or 102. If we were right, they'd go down a lot."

And today? "We are looking at a bunch of these big cap, astoundingly cheap American enterprises that are hiding in plain sight. Wal-Mart is one, J&J is another," he says. Wal-Mart he describes as a mature business whose per-share earnings are those of a growth company, thanks to its massive share buy-backs.

"We can observe that the dividend yield [on many blue-chip U.S. companies] is a match for most points on the Treasury yield curve. But their managements are adaptive, unlike the inert Treasury bond that you buy for so-called safety."

In the present macro environment, Mr. Grant adds, "you can't exactly predict whether the debt predicament or the printing press is going to get the upper hand in our affairs. Rather than hiding out in the unguided missiles including my beloved gold bullion, look at these impressively adaptive businesses that have managed to make a go of it in every political environment and even today."

The key is "adaptive"—willing and able to do what it takes to produce returns for shareholders. The lesson was painfully reinforced by his one foray into professional money-managing. In the late 1990s, with a partner, he raised money to invest in severely undervalued Japanese companies. "These bargains can and did remain bargains for 12 years," he says with a grimace, because Japanese managers don't need to care about shareholder wealth.

Mr. Grant is skeptical, scathing even, of the Japanese-style deflation fears that today motivate Mr. Bernanke's monetary spigots. Good deflation, he says, is "when prices fall as a result of productive processes and technical apparatus, that is called progress." Bad deflation is when merchants, drowning in debt and unable to get credit, dump goods at firesale prices. "The Fed refuses to make that distinction."

Hence a horrifying irony: After the dot-com crash, Alan Greenspan and Mr. Bernanke drove down interest rates to fight a feared deflation and ended up inflating the mortgage bubble. "The Fed, in assaulting a phantom deflation, precipitated an actual one."

Mr. Grant would prefer a monetary system tied to the amount of gold dug out of the ground to one based on the untrammeled discretion of Ph.Ds. The latter is what America got with President Nixon's 1971 decision to close the Treasury's gold window, breaking the last link to the classical gold standard, in which anyone was free to exchange dollars for gold at a fixed and guaranteed price. Result: the dollar, not gold, became the world's "reserve currency."

The U.S. government was empowered to borrow seemingly unlimited funds from foreigners and repay with a currency that the U.S. government itself could print. "Dollars pile up in Asia. Merchandise piles up here," says Mr. Grant, as America, in possession of the printing press, has tried to achieve the "ancient hope of mankind, to live without working."

The "fiat" dollar, he adds ruefully, "is one of the world's astounding monetary creations. That a currency of no intrinsic value is accepted as money the world over is an achievement that no monetary economist up until not so many decades ago could have imagined. It'll be 40 years next month that the dollar has been purely faith-based. I don't believe for a moment it's destined to go on much longer. I think the existing monetary arrangements are so precarious, so ill-founded and so destructive of the economic activity they are supposed to support and nurture, that they will be replaced by something better."

How exactly the transition to a new gold standard might take place is a puzzle, but Mr. Grant says he's seen many "impossible" things come to pass in his career. A certain "social spontaneity" might take a hand. He points to GLD—the ticker symbol for an exchange-traded fund whose gold holdings now make it equivalent to the world's 10th largest central bank. "At the margin," he says, "people are registering dissent from the judgment of our central bankers by bidding up the price of gold."

Earlier this year Mr. Grant put his mouth where his mouth is, testifying before Rep. Ron Paul's House monetary affairs subcommittee on the virtues of the gold standard. No Democrats and few Republicans showed up. Asked to predict exactly when the dollar will blow up, Mr. Grant jokes, "I'd say 1978."

But his point is an earnest one and brings us back to the modern character of Wall Street. The gold standard, he says, citing the "late, great" libertarian economist Murray Rothbard, was the "people's system. If you didn't like the currency, you could exchange your paper for gold and that sent a message."

In our age of "wiki everything," Mr. Grant finds it anomalous that we sacrifice freedom of monetary choice for the diktats of central planners acting out of the Fed's faux-colonnaded headquarters in D.C. The fiat dollar is an "elite" system, he says, and Wall Street is its supporting "interest group"—those nimble, market-savvy, plugged-in folks know how to shuffle assets and exploit cheap funding from the Fed to leverage up their profits and soften the downside.

'The winners in Wall Street have always been hugely rich and therefore have been objects of great envy and great populist animosity. This is one of the great evergreens of American politics," Mr. Grants says. But those earlier financiers "got to participate fully in the downside as well as the upside. Years ago, Goldman Sachs was a partnership and partners were at risk for everything they owned. I think it's fair to assume that attention to risk management is different now.

"Wall Street today is a statist creation," adds the man who has known, loved and chided the Street for nearly four decades as one of its most able observers. "Greenwich, Connecticut"—where billionaire hedge-fund operators keep their homes—"is not what Fifth Avenue was in the Edwardian age. Greenwich, Connecticut will be the last to sign up for the new gold standard."

As for Mr. Grant, it may turn out he's been cranking a wind machine after all—by steady effort and perspicacity, helping to move the ship of history back toward sounder monetary arrangements.

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