Myrmikan Research

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Truth

Myrmikan's purpose is to make money. But what motivates us is truth—not just in that we take positions in stocks because we believe the valuations that the market is imposing are incorrect, but on a societal level, anything that help gold return to the financial system is pursuant to truth as expressed in Leviticus: *You shall do no injustice in judgment, in measurement of length, weight, or volume. You shall have honest scales, honest weights, an honest ephah, and an honest hin: I* am *the Lord your God, who brought you out of the land of Egyp*t.

The faithful scale may seem trite when compared to more prominent Biblical lessons—the ten commandments, or loving thy neighbor as thyself—but the consequences of false measures threaten the foundations of civilization.

Capital is what separates man from the animal, and capital may be created only through savings. Consider Robinson Crusoe shipwrecked on his island barely subsisting on fish caught by hand. If he must spend all of his effort catching fish to survive, then he cannot save the resources necessary to invest in capital; he can never improve his condition. If, however, he has at least some surplus time, then he has a choice: he may spend it at leisure or he may continue to work and save the surplus. Once he has enough surplus fish, he may take time off from fishing to construct a fishing net, which will greatly enhance his productive capacity and allow him time to perform the more difficult task of building a hut. As Crusoe reaches the limits of what capital he can produce by himself, he will begin to enjoy more leisure time, the ultimate reward for his saving.

In an organized society, savers may transfer their capital through the money market to businesses that will use it for the most productive purposes. We have been trained to think of all such transactions as either equity investments or asset-based debt. The gold-standard of the nineteenth century offered a third choice: the bill market.

Imagine a simple supply chain of farmer, miller, baker. The miller sells his flour to the baker and receives a promise to pay in thirty days (about the length of time necessary to bake the flour into bread, sell it, and collect on store charge accounts). Needing to buy more flour and without cash to do so, the miller would endorse this bill on the baker (meaning accepting full liable for the bill along with the baker) and pay it over to the farmer, who accepts it because it is double-collateralized—but not quite at par. The double endorsement has removed credit risk, but the time value of money prompts the farmer to demand a slight discount.

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The typical supply chain extends much longer than three parties, and the original function of banks was to buy such credit-risk-free endorsed bills at a competitive discount rate and then collect the funds at maturity. Banks funded themselves with deposits, on which competition forced them to pay a competitive interest rate that approached the natural discount rate.

In this way, banks could offer depositors a real, risk-free return on capital equal to the market discount rate minus fees. And this meant that the more a man saved and delayed consumption, the more he could consume in the future (especially if technology is operating to reduce prices through innovation and increasing efficiency). Savers become naturally conservative because they develop a strong interest in having the future arrive unmolested. The richer a country became, and the further the ability to save spread, the more stable the country would become.

The discount system died along with the gold standard in World War 1. Since then, banks have used deposits to fund asset purchases, the government has debased the currency at erratic rates, and these combine to create the two most destructive pathologies of modern times: speculation and overconsumption.

The first problem with money printing, as George Washington noted in 1787, is "the door it immediately opens for speculation, by which the least designing, and perhaps most valuable, part of the community are preyed upon by the more knowing and crafty speculators."

The crafty should be busy starting business or inventing things. Instead they fill their heads with financial figures, as shortly followed in France:

> With the plethora of paper currency in 1791 appeared the first evidences of that cancerous disease which always follows large issues of irredeemable currency.... [A]t the great metropolitan centers grew a luxurious, speculative, stock-gambling body, which, like a malignant tumor, absorbed into itself the strength of the nation and sent out its cancerous fibres to the remotest hamlets. At these city centers abundant wealth seemed to be piled up: in the country at large there grew a dislike of steady labor and a contempt for moderate gains and simple living.... In the schemes and speculations put forth by stock-jobbers and stimulated by the printing of more currency, multitudes of small fortunes were absorbed and lost while a few swollen fortunes were rapidly aggregated in the larger cities....

Then came the speculation following the War of 1812, which Washington Irving witnessed:

> Every one now talks in thousands; nothing is heard but gigantic operations in trade; great purchases and sales of real property, and immense sums made at every transfer. All, to be sure, as yet exists in promise; but the believer in promises calculates the aggregate as solid capital, and falls back in amazement at the amount of public wealth, the "unexampled state of public prosperity."
>
> Now is the time for speculative and dreaming or designing men. They relate their dreams and projects to the ignorant and credulous, dazzle them with golden visions, and set them madding after shadows. The example of one stimulates another; speculation rises on speculation; bubble rises on bubble; every one helps with his breath to swell the

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> windy superstructure, and admires and wonders at the magnitude of the inflation he has contributed to produce.

This same commentary was offered by another author in 1867 during the inflationary greenback period: "During the last few years large numbers of our population, under the influence and example of high profits realized in trading during the period of monetary expansion, have abandoned employments directly productive of national wealth, and sought employments connected with commerce, trading, or speculation."

And how similar is this commentary about the 1960s:

> Paperwork and office workers proliferated, as they did in Germany [during the Weimar hyperinflation]. The Xerox machine and the IBM machine, both paperwork machines, were the twin monuments of the decade. Bank buildings and office buildings were the most conspicuous form of construction. The office equipment industry was the most glamorous of industries. . . . Not only did fringe activities like these show the largest growth and the most new jobs, but they also showed the most price inflation which meant that they were generally more lucrative than productive work.…
>
> Legions of Americans—investors, conglomerators, brokers, advisers, lawyers, accountants, analysts, clerks, programmers, bureaucrats, and so forth—served the business of making money with money and creating absolutely nothing even as a byproduct.…

The modern version of this—the private equity industry—is not content with creating nothing; it actually operates to destroy businesses and feed on their bones.

The tragedy is that while most people would prefer not to speculate, to enjoy instead the safe, steady gains on their capital once offered by the bill market, constant currency devaluation forces them into speculation whether they have any acumen for it or not.

Everyone wins at first. Eventually the bubbles pops. "Most men thought it wou'd come," reflected Alexander Pope after the South Sea Bubble burst: "but no man prepar'd for it; no man considered it would come like a Thief in the night.… They have dreamed out their dream, and awakening have found nothing in their hands."

Debasing the currency not only encourages speculation over productivity, it also penalizes savings, thereby encouraging immediate consumption: "Vulgar pleasure-seeking and wild extravagance became habitual even in the lowest classes," observed a nineteenth-century historian of the Austrian debasement of the 1810s: "Of what use to care for the future? Why not enjoy today all the pleasures of the senses? How could any one hesitate to pay 200 gulden for admission to a ball? In fact the 'money' had no value, and, if one stood reflecting, he might lose ball and money both."

The inability to save monetary capital and the concentration of capital by large speculators leaves the typical person with no hope for the future. Economist Elgin Grosclose noted the result:

> Beginning in the 1960's, as many observers have noted, there occurred a widespread dissatisfaction with not only government—which may have been the result of involvement in an unpopular war—but

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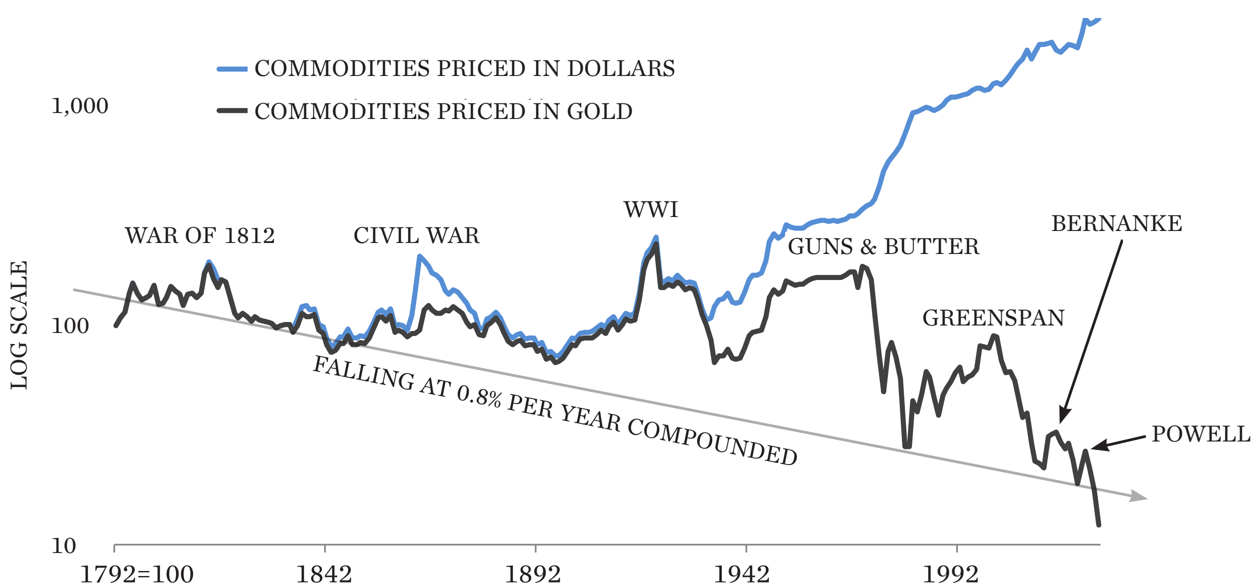
> with "establishments" unrelated to politics—from school to church, including conventions of behavior and dress. Young people took to living together without benefit of clerk or clergy … the use of narcotics and drug stimulants became open and even fashionable. Accompanying these happenings was an enormous increase in crime—bank robberies, murder, rape and sodomy, masochism, torture, child abuse.[1]

It not by accident that the Keynesian capture of money and credit in the 1960s has resulted in the collapse of Christianity and a coarsening of the culture to a degree unknown since the later Roman Empire. Today at least 14 percent of internet searches are for pornography; only 35 percent of Americans think it is morally wrong to have a child outside of wedlock. The drug holocaust that began in the cities when Great Society programs penalized blacks for working has spread to working class whites, who are penalized for saving: of the 7 million men aged 25–54 who are no longer working, nearly half take pain medication (two-thirds of whom admit to taking prescription pain medication daily). Drugs are the ultimate expression of current consumption at the expense of capital improvement.

Only constant innovation (not division of labor) can overcome an otherwise Malthusian world; innovation must be financed from savings; savings is a *bourgeois* endeavor. And, thus, the fatal flaw at the core of an inflationary system: capital ceases to provide a real return for the mass of savers, and so it is consumed: social and economic ruin must follow.

The individual cannot prevent the arc of the credit cycle nor the destruction of culture, but he can at least side-step it: gold offers a reprieve, and not merely against debasement. Ignorant commentators charge that gold offers no yield; that it is economically sterile; that its sole use case is as monetary insurance, which requires perfect timing. Myrmikan's favorite chart refutes this charge.



1 The number of violent crimes in the United States increased from 161 per 100,000 in 1960 to 593 by 1981. FBI, Uniform Crime Reports, prepared by the National Archive of Criminal Justice Data.

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Technology lowers the costs of production of all commodities and goods. Because gold mining adds only 1.5% to the above-ground supply each year, the falling (real) costs of mining gold have little influence on gold's value. Therefore, the value of other commodities falls compared to gold over time.

The value of consumer goods also falls in terms of their commodity components, which means that gold's real purchasing power increases sharply over time. Gold has a yield in real purchasing power terms, making gold bullion an excellent means to save, which explains man's propensity to store it in vaults for the future, and offering an alternative to the corrupt banking and currency systems.

The persistent fall of commodities in terms of gold is interrupted by credit bubbles, which form when banks monetize government debt, usually (though not always) during war. The new credit money bids on assets, which lowers interest rates. A falling cost of capital encourages especially the development of capital/commodity intense projects. There is little industrial demand for gold, which underperforms during the boom. Overcapacity then lowers prices, which causes malinvestments to default and demand for industrial commodities to collapse. Because gold is relatively unaffected by the cycle, it outperforms during the bust.

Gold mining margins are driven by the spread between industrial commodities (the costs of mining) and gold (the output). Therefore, gold mining cash flows and equity returns underperform during booms and excel during busts: they are counter-cyclical and are an essential part of a balanced portfolio.

The chart above is extraordinary because the commodity-to-gold ratio has breached a 233-year trend line. And the panic has not even yet started! Imagine how much higher gold must rise in real and nominal terms when the private credit market implodes and the Fed is forced to react.

We look forward to the bust not only to validate Myrmikan's investment thesis but, more importantly, because of Treasury Secretary Andrew Mellon's 1929 insight: "Liquidate labor, liquidate stocks, liquidate the farmers, liquidate real estate.… It will purge the rottenness out of the system. High costs of living and high living will come down. People will work harder, live a more moral life. Values will be adjusted, and enterprising people will pick up the wrecks from less competent people."

Mellon was speaking of the immorality of a credit inflation. Adding currency debasement magnifies the debasement of civilization, as observed by Congressman Josiah Patterson in 1895:

> Looking abroad over the world I do not find a single country where Christianity and civilization are progressing, where the arts and the sciences are in the ascendant, where trade and commerce are growing, where schools and colleges flourish, where men and women are comparatively happy, where government is stable, and the laboring man earns a good wage for a day's work, that is not on the gold standard. On the other hand, I do not find a country where civilization and Christianity are retrograding, where the arts and sciences are backward, where schools and colleges are decaying, where revolutions are perennial, where men and women have no cause to be happy, and the laboring man is paid a miserable wage for a day's work, which is not on the [inflationary] silver basis. I do not say that all the highly enlightened, Christianized and

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> prosperous nations are such because they have the gold standard, but I do say that all such nations have adopted it, demonstrating that gold is the standard of civilization and Christianity, of commerce and of labor.

We recognize Patterson's warning as the world we live in, the world that chose inflation. And we're about to get more of it. Last week the Fed restarted QE, only this time they are calling it reserve management purchases (RMP). Bernanke's initial QE, announced in November 2008, was $600 billion, and it caused a firestorm of controversy. RMP is open-ended, commencing at $40 billion per month, and no one seems to care. The Fed says the pace of printing will slow after a few months; and Bernanke said it would be necessary to return the Fed's balanced sheet to its pre-QE size. As the private credit market continues to unwind, the pace of printing will grow. The system requires not just money printing, but printing money on an accelerating basis.

The only hope for civilization is liquidation, and not just of the market. We need to liquidate the Fed, liquidate the currency system. The market is already doing so to the dollar internationally, with gold returning to its role of balancing trade and being the preeminent reserve. As individuals begin to shift their personal reserves into gold, the dollar will becoming increasingly irrelevant domestically as well.

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