

The following article was written by my late father, Larry H. Abraham, as the lead piece in the June 2002, edition of his world-renowned and globally-circulated newsletter, *Larry Abraham's Insider Report*. With the exception of correcting typos and including the charts at the end for reference purposes, nothing in the following article has been amended, changed to reflect current realities or altered in any way.

As you will read this article is as prescient today as it was the day he wrote it. In fact, more so as you now have the advantage of nearly eight years of hindsight to check his assertions, question his assumptions and, undoubtedly, come to admire the depth of his understanding of history, geopolitics, economics and their impacts upon currency, equity and commodities markets, worldwide.

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TIME TO CHOOSE; CONFIDENCE OR GOLD

The late Prof. C. Northcote Parkinson said and wrote many things worth remembering, but one of his least-known observations needs to be discussed and learned immediately. Writing in a book entitled *The Law and the Profits*, Parkinson turned his acerbic analysis to currency, observing: "the speed of which currency depreciates is in direct proportion to how often the word 'confidence' is used to support it." (I put this in quotes because, however imprecise my memory may be of this epigram, I want to credit the wit and the idea to the author.)

In today's world, you could substitute currency for "markets" and "the economy" just as readily. Parkinson knew we were living in an age of irredeemable fiat currencies, and that rather than have these currencies valued in ounces of gold the politicians would have us play off perceptions of the value of "currency" against one another based solely on their political decisions arising from notions of "confidence."

For a number of years now we have watched as the U.S. dollar grew more valuable and the world at large placed confidence in it over that of the competing paper of other nations. An effective PR job built confidence in the dollar and had a profound impact on a wide range of monetary and economic phenomena. Before I recount some of these "strong-dollar" effects and why it now is coming to an end, and what to do about it, let me lay in some quite recent history about another time and how it too affected everything.

My purpose will become obvious, but I am going to go back forty years and then come forward to describe two time spans of twenty years each. The first period is 1961 to 1981, and the second is 1981 to 2001. As you will soon see, the speed of Parkinson's Law on Money increases as we move forward in time. These two "long waves" speak to inflation and dollar weakness and dis-inflations and dollar strength.

TWO DECADES OF DESTRUCTION: 1961-1981

In 1961, John F. Kennedy became president of the United States. Taxes were reduced and the resultant productivity started to ramp up. At this time and ever since the Bretton Woods Agreement of 1944, the U.S. dollar was fully convertible to gold by foreign countries at fixed exchange rates of \$35 to one ounce of gold. All over the world the popular adage used to describe the dollar was: "As good as gold." Indeed, it was.

Then, early in the JFK years came the Vietnam War, which escalated under his successor Lyndon Johnson. A handful of Green Beret advisors soon were replaced by battalions of Army and Marine regulars. Never having been much of a foreign-policy wonk, the beleaguered and ever prevaricating, Johnson responded to growing anxiety about the economic consequences of the war in the only way he knew: increased government spending, pumping more currency into a system already stalling out due to an over-emphasis on the military imperative. During this phase a reporter asked whether we would have "guns or butter." Johnson's reply was "both."

The first crack in what had been a sound dollar came in 1964 when LBJ's treasury department cut what had been 90 percent silver content in coins to 50 percent and then a year later to zero. Some of our brighter and more sophisticated fellow citizens (those who had read such books as *Fiat Money Inflation in France*) quickly became rich by going out and gathering up 90 percent silver coins in exchange for the new ones. Silver, just like its big brother gold, had been supported by a fixed price of \$1.29 per ounce ever since the days of William Jennings Bryan, but it wasn't to last long.

After taking silver out of coinage, the government announced it no longer would be both buyer and seller of silver at the supported price and silver prices started to move upward. While gold was still fixed at \$35 per ounce, the anticipation of big changes coming in the dollar produced what was called the "gold rush of 1966" as South African gold shares began a dramatic move to the upside.

As the war and the economy roiled the nation, Johnson abdicated, Robert Kennedy was assassinated by a Palestinian, and Richard Nixon moved into the Oval Office. The dollar no longer was being trusted. Johnson's policies of tax and tax, spend and spend for guns and butter, supported by Federal Reserve expansion of the money supply, set off the first alarms about monetary and price inflation. Rather than reverse the "Great Society," Nixon kept it and added his own big-government programs. European governments, especially the French under Charles de Gaulle, lined up at the U.S. Treasury with their dollars and demanded gold. The French, of course, already had experienced being bled white in the quagmire of Southeast Asia and having to retreat from their colonial holdings following their defeat there in 1954. De Gaulle turned a deaf ear to talk about "confidence" in the dollar and demanded the hard stuff.

Then came August 15, 1971, a Sunday. With the markets closed, President Nixon took to the airwaves and closed the gold window, formally devaluing the dollar by raising the official price from \$35 to \$37.50 and announcing his efforts to control inflation by imposing wage and price controls. The age of inflation was now "official" even though the inflation rate was somewhere between 3 and 4 percent. People all over the world began the rush to precious metals. By law, U.S. citizens, were not allowed to hold gold bullion, but they could purchase "numismatic" coins with high gold content as well as silver.

By late 1972 and early 1973, the rush to precious metals had taken on huge proportions. Nixon had been re-elected in a landslide against the hapless George McGovern, but the Watergate scandals soon had him hiding in the White House bunkers as official Washington

mooded endlessly about “confidence” in the dollar. Following Nixon’s resignation, his vice president Gerald Ford stumbled into office and, rather than reversing the failed policies of his predecessors, decided to launch his own initiatives with the humorous battle cry, “Whip Inflation Now (WIN)” and even produced lapel buttons with a blue background and the capital letters “WIN” in white to make the point. My friend Scott Stanley quipped that it would have worked except they ran out of whips. Gold started to move up dramatically, as did silver, while dollar confidence was in freefall.

Americans still were not allowed to own gold, but gold-based numismatics were creating a huge secondary market and 90 percent silver coins were being sold in canvas bags. Incidentally, it was during this time that I started my career in investments by joining the Pacific Coast Coin Exchange, later name “Monex,” under its very capable and visionary founder Louis Carabini. Monex still is doing what it does best, supplying the most reliable outlet for precious metals anywhere in the country.

As silver move up to \$5 and \$6 per ounce, gold was heading for \$100 per ounce and the term “barbaric relic” was introduced by gold hating economists and politicians. The Nobel Prize-winning economist Paul Samuelson, a Keynesian, announced from his Athenian perch, “I would not want to live in a world where gold was \$100 per ounce.”

He didn’t have any choice but to fall on his sword—which, of course, he never did.

Jimmy, Rosalynn, and the Georgia good ol’ boys took up residence at 1600 Pennsylvania Avenue in 1977 while Gerald Ford gathered up his WIN buttons and headed off for the board rooms and golf courses where his inept golf swing did almost as much damage to onlookers as did his fiscal and monetary policies.

OPEC oil producers, being paid in dollars per barrel, set about the business of discounting future production to the dollar and prices for crude started to skyrocket along with their cousin commodities, led again by gold and silver.

Confidence in the dollar had become a cruel joke. Interest rates soared to 20 percent, bond markets collapsed, consumer prices were being adjusted skyward weekly, or in some cases, daily. A paragon of political virtue, the economic simpleton Jimmy Carter donned his cardigan sweater and sat beside a White House fireplace muttering about *malaise* as Americans rushed out to buy precious metals and take their place in the gas lines at the neighborhood gas station.

Then came the final indignity: The U.S. Embassy was stormed in Iran and hostages taken. After Jimmy had assured the world that his administration could not possibly tolerate “human-rights abuses” of the type mandated by the Shah, the Shah was forced into political exile and radical Islam led by the Ayatollah Khomeini had a secure base from which it could conduct its jihads against the West.

By the time election year 1980 rolled around, oil was over \$35 per barrel. Dollar denominated credit cards were being refused at European hotels and restaurants, silver had soared over \$50 per ounce, and gold was up to \$850 an ounce and headed for \$1,000. Inflation had become a way of life, while fixed income retirees watched helplessly as their CDs, annuities, and bond portfolios fell into deep discount.

Some “wags” were calling the U.S. “the largest of the banana republics” as black markets arose to circumvent price controls in every Middlesex village and farm.

Also by this time, the word “confidence” to describe the dollar had become not a cruel joke, but an ugly reality. Some few among us got big-rich by doing exactly the opposite of what little Jimmy begged us to do. Predictably, we were held out as profiteers, price gougers, greedy speculators, gold bugs—and one of Carter’s advisors even proposed a wealth-confiscation tax to be applied to anyone who had purchased precious metals or “hoarded” much-needed commodities of other kinds. We had become what the **New York Times** called “enemies of the state,” simply because we lacked “confidence.”

As the Greeks observed 2,000 years earlier, “whom the gods would destroy, they first make mad.” The country had become a madhouse with the worst inmates in charge of the books and the dollar in a straitjacket.

THE RESTORATION: 1981-2001

So, at this point, we drop the curtain on the first twenty years of the forty-year retrospective. As we do so, Jimmy is departing Washington with his hand carried suit bag, Rosalynn is snubbing Nancy Reagan, the good ol’ boys are driving back to Georgia in their pickup trucks, and the country at large (including the not-so-mighty dollar) is inspiring about as much confidence as Mike Tyson at a sorority party.

Enter Ronald Reagan, and what the **Washington Post** called his “posse of cowboys.”

I remember this period as if it were yesterday, and at the very moment Reagan was sworn-in on the steps of the Capitol, a U.S. military transport plane was lifting off the airfield in Tehran with our hostages bound for home. No one ever explained the particulars of this dramatic gesture, but it came out years later that Mr. Reagan’s CIA appointee, Bill Casey, had sent a message to the Ayatollah via Saudi Arabia that if the hostages weren’t returned immediately Mr. Reagan would, before raising his first glass of champagne, sign an executive order to direct that the Ayatollah and his fellow mullahs be blasted back into the Stone Age. Apparently, the Ayatollah and his minions were not ready just yet to join their 72 virgins in heaven.

The first beam of “confidence” in the dollar to shine through in over twenty years fell gracefully upon Old Glory.

Some other things to remember about this period are as follows: The Dow Jones Industrial Averages fared worse in the 1961-1981 time period than at any other similar period since the depths of the Great Depression in 1933-1934. Annual growth did not keep up with the inflation rate, and there were three severe recessions—in 1962-63, 1969-71, and the worst, 1973-74.

The Dow was at 648.20 in January 1961 and in January 1981 it was 940.10. But much of the gain came in after the Reagan presidential victory.

Many market mavens would have us believe that common stocks protect against inflation. Not true. So-called “monetary experts” would have us believe that a weak dollar is good for foreign trade. Again, not true. Watch for this sort of nonsense to start re-appearing.

While the Dow Jones Industrial Average was at 648.20 in January of 1961, and 940.10 in January of 1981, along the way they hit highs of 1020 at year-end 1972, after McGovern was routed and then proceeded to lose 10 percent in the next nine years when the inflation rate

was at its worst. The Dow also gained over 100 points from mid-1980, in anticipation of Reagan's presidential triumph.

Obviously, during the depths of the 1973-75, depression, as Nixon swung slowly in the wind, it was lower than it was in 1961, twelve years earlier. There was no significant gold/silver stock index to won—that didn't come until 1984. Indeed, American citizens were not allowed to own or buy gold bullion legally until 1975, a seminal change that came about due to the relentless efforts of James Blanchard III, my late and dear friend, who helped countless people preserve their purchasing power during that crazy period.

The rise of precious metals from 1961 to 1981 did not go on straight ascending line. It was one hellacious ride with daily price-swings of 20 percent both up and down in silver futures markets. Most who tried to time and play the commodity markets were busted out—including the Hunt brothers—while those who bought precious metals stocks made fortunes. But that, too, required some sound and disciplined selling strategies. What happened to Bunker and Herbert Hunt was nothing less than political reprisal led by the Fed Chairman Paul Volcker and the silver industry short sellers. It was all laid bare in a book by the late Paul Sarnoff, *The Silver Bulls*.

And finally, for our current purposes and going forward, it should be remember that not one in ten of the current crop of Wall Street wizards were around when all of the above was taking place. Furthermore, they have been trained to hate gold as an investment and to look down their noses at anyone who might even suggest it as a sound investment alternative. This time around, these attitudes will be even more pronounced.

Now, let's survey the most recent twenty-year period from 1981 to 2001, or to be more exact, from November 1980 to September 11, 2001.

Immediately prior to Ronald Reagan's winning the election, in November 1980, precious metals hit a double top both in stock prices and as commodities. I remember attending and speaking at the Blanchard conference in New Orleans where over 5,000 guests were dancing in the aisles over their gold bug riches. Speaker after speaker announced to the salivating throng that gold was a sure-fire bet to go over \$1,000 per ounce and silver over \$100 per ounce.

After observing this maddening crowd for two days, I went to the exhibit booth being manned by my gold-stock broker at the time, Jerry Pogue of National Securities, and told him to call his office and sell me out of my entire position. He thought I had gone insane, but did as I asked. It proved to be the only time in my life, before or since, that I sold at the top while having bought at the bottom.

As I stated above, things really started to change on the very day Mr. Reagan was sworn into office. Shortly after welcoming home our hostages, the new president rushed to pass his tax-cutting package, slow the rate of government spending, and lean on Federal Reserve Chairman Paul Volcker to dis-inflate by raising interest rates and hit the brakes on the money supply.

Reagan knew, as did any knowledgeable economist (such as domestic affairs advisor Dr. Martin Anderson) that these measures were going to cause some temporary pain, but that they were absolutely necessary. He knew that cutting marginal tax rates dramatically would create capital spending, and that if "confidence" in the dollar were not restored the whole system would come crashing down.

Another aspect of Reagan policy that has been overlooked is how he marketed his political clout to clean up the money-center bank mess. When he took office, most of the U.S. money-center banks held defaulted third-world loans in excess of their shareholders equity and were on the verge of total collapse: Citibank, Chase, Chemical and Manufacturers Hanover—all had negative worth while their dollar-denominated assets were being discounted on a daily basis.

People have either forgotten or never really knew just how close the U.S. was to financial panic and subsequent collapse. What Ronald Reagan did in an eight-year period at the White House was truly remarkable when we examine it in retrospect. What is even more astounding is that he did it in spite of what was for most of those years a hostile Congress and press establishment that hated his guts and resisted his policies. By the sheer force of his personality and communication skills he led not only the America people but the nation's currency back to respectability.

The capital markets, as we now know them, were a direct result of Reagan policies. Inflation was whipped, but not with inspired slogans and lapel buttons, but by having the courage and vision to do the necessary things to dis-inflate. Oil prices went from \$38 a barrel down to a low of \$12.50; gold from \$850 to \$240; silver from \$50 to \$2 and change. All the while the dollar began its relentless climb back to the pinnacle of world currencies. Nobody had to urge “confidence,” it was happening naturally - the word all but disappeared from financial reporting.

By the time 1989 rolled around Reagan waved goodbye while taking off from the White House lawn in the presidential helicopter, the economy was on a roll, the Cold War had been all but ended (thanks again to his courage and vision) Americans felt good about themselves, and people world-wide rushed to the dollar as the haven of security whenever trouble befell them in their own countries.

The next few years under George Bush, the elder, was the same until he failed to read his own lips and caved into the pressures of raising taxes. In all, this move in and of itself would not have created much harm had it not allowed the political ascendancy of Bill and Hillary along with the huge deficits resulting from the Gulf War.

While the Clinton spin-doctors rushed to claim every little bit of growing economic clout as their own creation, the real truth is that they were only the latest beneficiaries of the Reagan policies. In spite of scandals and the growing use of bawdy-house humor about the bimbo eruptions, a host of external developments continued to bolster the dollar. There was increasing unrest in the form of terrorism in the Middle East, monetary meltdowns among the Asian tigers, Japanese economic failures, South America once again was acting like South America, and Africa got darker with each passing year, plus the restoration of European Socialism at the polls. All converged to make the U.S. dollar the currency of last resort. This was exacerbated by the growing fears (throughout 1998 until December 31, 1999) about what a Y2K meltdown might do.

Everywhere I went throughout the world, everyone wanted dollars. The Yankee dollar was the de-facto world currency in spite of the fact that the Fed had its pedal to the metal and the Treasury printing presses were operating around the clock just to meet daily demands. But when January 1, 2000, dawned and the lights were still on the Fed knew it had to retract hundreds of billions of greenbacks or those billions were going to come flooding back into

the U.S. creating what Mr. Greenspan feared above all else...*price* inflation. The *monetary* inflation already had happened.

Higher interest rates saw excess liquidity move into the bond market and forestall both monetary inflation and its consequential price inflation. It also put an end to “irrational exuberance,” for in a short three months into the new millennium we saw the first big crack in the NASDAQ bubble.

By mid-summer of 2000, to change the metaphor, the whole of Wall Street had exhausted all digits as they tried to plug the leaks coming from everywhere in the NASDAQ dike. Confidence had been shaken—at least in the high-flying “new economy”—and Greenspan and the Fed kept right on raising rates. That sucking sound we heard was liquidity being vacuumed out of the stock markets at the same time countless billions were rushing to money heaven.

As the U.S. neared the presidential elections in November 2000, a Bush rally was starting to rebuild market and dollar confidence, but when the final outcome was put in doubt along with the Fed’s lost cause on interest rates, confidence in both the stock markets and the U.S. dollar became increasingly illusive. Just when it appeared that G.W. would be able to take the initiative after finally being acknowledged the winner, the move by Vermont turncoat Jim Jeffords destroyed the Republican majority in the Senate. The markets and the dollar slumped again.

By June of 2001, after struggling back from April lows, the first indications of the Enron debacle started breaking. The perfect storm was now building, and it hit in all its fury with the cyclonic madness of September 11. The next day, the world held its breath waiting for the U.S. markets to reopen.

WHERE WE ARE NOW AND WHY

Coupled with the real confidence the president inspired by his resolute leadership the innate optimism of the American people staved off total collapse. But now we are eight months into what is really a new paradigm, and the hard, cold facts of our situation are starting to be fully realized world-wide.

Here are those realities:

- The U.S. is no longer the safest place on earth.
- The U.S. banking institutions, including the Fed window, could go up in flames in the blink of an eye.
- Instead of joining a worldwide initiative against terrorism, the terrorist-harboring countries are becoming increasingly emboldened and more anti-American every day.
- Rather than tighten the American belt in the face of a need for huge military and domestic security spending, the White House and the Congress have adopted the Johnson principle of *both* “guns and butter.”
- The Fed is frozen like a deer in the headlights between that proverbial rock and hard place. If it raises rates to help the dollar, it panics the equity markets even more and billions more are lost to capital spending needs.
- Some of our biggest and most recognized institutions are now suspect as to their profits reporting. The biggest of the big five accounting firms is being dismantled. The biggest of the Wall Street brokerage firms just signed a consent decree and is now waiting for the circling trial lawyers.

- The rest of Wall Street is waiting for the process servers to appear, as indeed they will.
- The student riots and marches led by the never-sleeping radical left were starting to appear once again at the end of the spring term and may escalate in the fall.
- Europe is putting distance between itself and the U.S. just as it did during the darkest days of the Vietnam War.
- GOP congressional leadership has become emasculated, and its only action has been to try to outbid Democratic rivals in the vote-buying sweepstakes. Deficits now are projected in excess of \$100 billion and growing.
- In order to deflect political heat from their own failure to stop the “axis of evil” from again striking the country, administration spokesmen are preparing the nation for years of terrorism against vital services—saying it is not a matter of *if* but *when*.
- Smart money worldwide is now starting to hedge the dollar and dollar-denominated assets. And finally:
- For the first time in years the Japanese Central Bank has been in the international currency markets buying dollars to keep the Yen from appreciating too rapidly. These methods of intervention usually don’t last long and are almost always doomed to fail.

So, dear readers, we come to the end of our retrospective, and drawing any similarities between what is happening now and what happened thirty-plus years ago could launch the prices of the precious metals, followed by pleas to have “confidence” in the dollar. What is even more sobering is that none of the above even raises the question of what could happen under some of the worst-case scenarios now making the rounds.

To put our conclusion within the current rhetoric, the probability is that the skyrocketing of precious metals has already started. And what happens when the current investment dollars in mutual funds start to discover precious metals stocks? It has been estimated that the total amount of investment dollars currently in precious-metals stocks or commodities does not exceed one percent of total investments or even match the market capitalization of Intel, a single Dow stock.

If the public desire to buy gold or gold stocks rise to 5 percent of invested funds it could create a rush against the aboveground inventory of central bank gold, including the U.S. supply, and drive prices to the moon. With silver, there is no strategic reserve, and the shortfall in supply goes up every year.

And another scenario is developing for which the consequences are incalculable. That is the short position on gold bullion as a result of what was called the “Carry Trade.” Big brokerage and commodity dealers borrowed gold from central banks, paying a ridiculously low interest rate, sold it, and proceeded to invest the funds at higher interest rates in stocks, pocketing the difference. What happens when they have to go to the market to repay the gold loans with gold itself?

Another little known fact completely ignored by the financial media is that within the last six months the Chinese government has dropped its ban against gold ownership while becoming a constant buyer in the central bank gold auctions of the West. The wealth effect is just starting to take hold in China, and as the surplus wealth grows and confidence in the U.S. dollar drops, the Chinese will do as they have always done. They will buy gold.

As I speculated within these pages less than a year ago, it wouldn’t surprise me at all if the Chinese government put a gold component into the nation’s currency immediately prior to dropping currency exchange controls and direct foreign investment. The current timetable for this is the fourth quarter of 2003.

So here's the bottom line: I can reasonably construct dozens of scenarios which will put severe upside pressure on precious-metals prices and commodities in general, but within the framework of current political and economic policies I am hard-pressed to find even one scenario which would restore "confidence" in the dollar and reverse the price auction already underpinning precious metals prices.

I also believe we are on the threshold of another long wave similar to the two described above which could take another ten to twenty years to play out. If this is true, just as was the case with the periods which preceded us, the world will look a lot different as to economic and political power than it does now. In the meantime, keep a sharp ear out for the word "confidence," especially as it relates to the dollar. Every time you hear a Treasury official, Fed functionary, or Wall Street guru use it, go out and buy more precious metals and shares of those quality companies that explore and produce same.

Larry H. Abraham, 1939 – 2008, was the father of eleven children, grandfather to 32 children and great-grandfather to 4 (and growing). A co-founder and Chairman of PanAmerica Capital Group, Inc., a Panama-based investment bank and wealth management firm www.panamerica-group.com and long-time author and editor of the *Insider Report*, an international geopolitical investment newsletter with over 10,000 world-wide subscribers at its apex. Mr. Abraham was also an international bestselling author and co-author of 3 books: *Non-Dare Call It Conspiracy*, *Call It Conspiracy* and *The Greening*.

Charts of Interest:

1. Spot gold price in monthly terms from 1960.



2. Dow Jones Industrial Average in monthly terms from 1960.



3. US dollar index in monthly terms from 1960.



*The U.S. Dollar Index (DXY) indicates the general value of the US dollar by averaging it against its exchange rate versus 6 of the worlds other major currencies.