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The Long Wave Analyst

'An Opportune and Strategic Investment Approach'

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The Long Wave Analyst is an investment strategy based upon historical analysis and interpretation of the "Kondratieff Cycle". Fax interpretation available between publications on significant market developments.

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Ian Gordon

Four Kondratieff Cycles 1789-1999

"The farther backward you can look, the farther forward you can see." Winston Churchill.

The beginning of the first Kondratieff Cycle can be traced to the dawn of the Industrial Revolution, which happened a little more than two hundred years ago. Within that relatively short span in time, this long economic wave has almost completed four cycles, and that affords us an opportunity to look to the future and determine the most likely economic and investment outcome over the short term.

This newsletter has consistently voiced the opinion that the Kondratieff Cycle is presently at the cusp of Autumn. The evidence given to arrive at this conclusion is overwhelming and includes the following:-

?? excessive speculation in US stocks and their extreme valuations;
?? inordinate amount of debt that is inherent in the US economy;
?? 'new era' thinking;
?? greed permeating US society;
?? depression in the agricultural sector;
?? recurring worldwide currency crises.

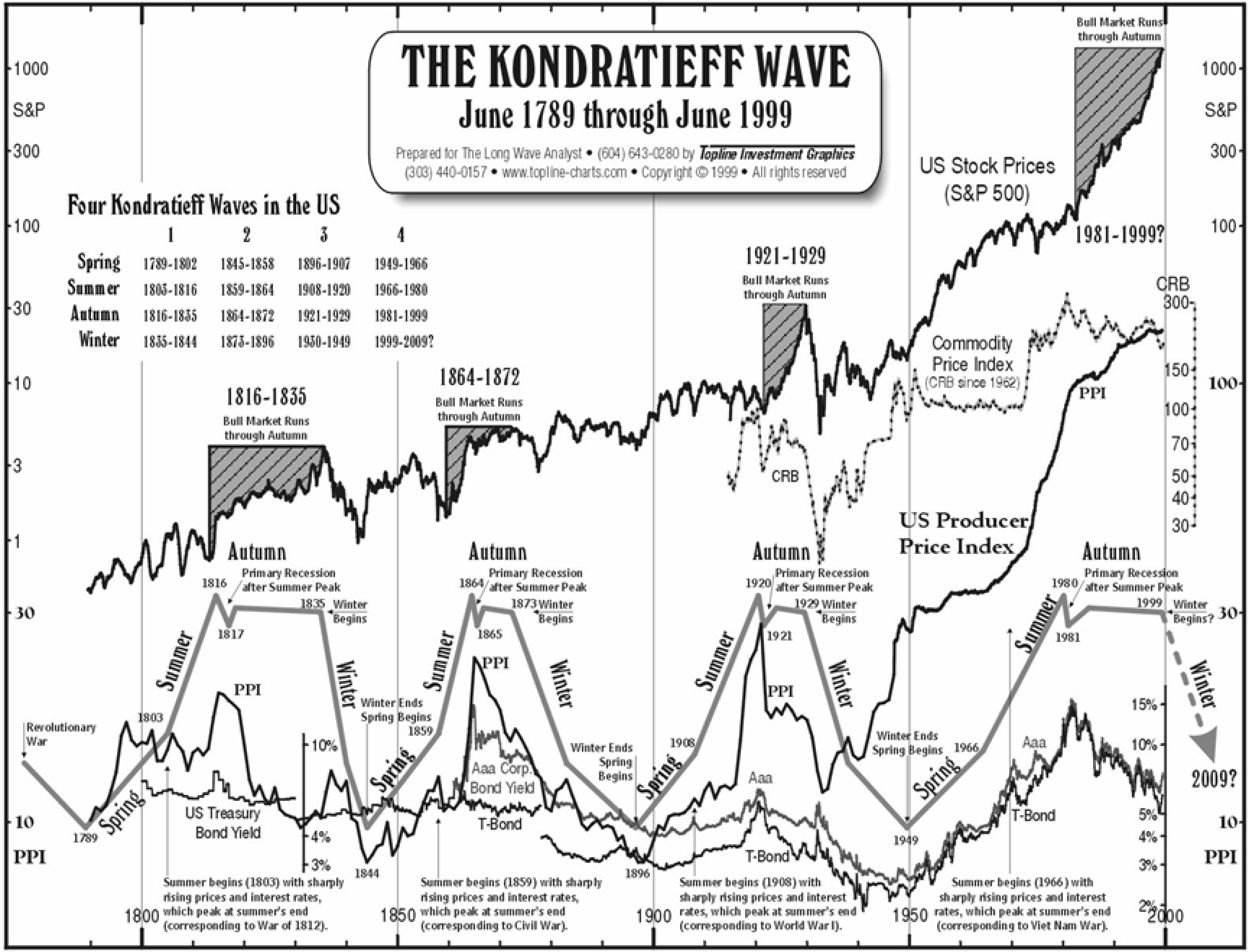
The beginning of the US Kondratieff winter is likely to be signaled by a stock market crash and the stock market is now ripe for such an event, because:-

?? The majority of US companies are trading at unprecedented stock values. If employee stock options were included as an expense on the balance sheet, which they should be, these values would be close to the ridiculous value accorded the Nikkei in 1989, when it traded at a Price Earnings ratio of more than 60 times.

?? The huge amount of speculation which is in the markets evidenced, not only by stock values, but also by the enormous overhang of derivatives on all markets and the possibility that inordinate derivative exposure could bring down the US banking system. (But for Alan Greenspan, LTCM almost did just that)

?? According to Bob Gabele, director of insider research at First Call/Thomson Financial, employee option grants issued on Nasdaq 100 companies alone between 1994 and 1998 were worth a staggering $220,000 billion at recent prices. These options are an menace to the market and are likely to be exercised in the face of a declining market, which would exacerbate the downside pressure on prices.

?? The technical divergence evidenced by the poor breadth in the market in spite of rising stock prices. Breadth, which is measured by advancing stocks versus declining stocks, topped in April 1998. Meanwhile, the Dow Jones Industrials made a new high in August 1999. The last time such a divergence occurred over a long period of time was when the breadth of the market reached its peak in June 1928, but the Dow Jones Industrials continued higher and ended its


THE KONDRATIEFF WAVE
June 1789 through June 1999
Prepared for The Long Wave Analyst • (604) 643-0280 by Topline Investment Graphics
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Four Kondratieff Waves in the US
1 2 3 4
Spring 1789-1802 1845-1858 1896-1907 1949-1966
Summer 1803-1816 1859-1864 1908-1920 1966-1980
Autumn 1816-1835 1864-1872 1921-1929 1981-1999
Winter 1835-1844 1873-1896 1930-1949 1999-2009?
US Stock Prices (S&P 500)
1816-1835 Bull Market Runs through Autumn
1864-1872 Bull Market Runs through Autumn
1921-1929 Bull Market Runs through Autumn
1981-1999? Bull Market Runs through Autumn
Commodity Price Index (CRB since 1962)
CRB
US Producer Price Index
PPI
Revolutionary War
Spring
Summer
Autumn
Winter
Primary Recession after Summer Peak
Winter Begins
Winter Ends Spring Begins
Winter Begins?
2009?
US Treasury Bond Yield
Aaa Corp. Bond Yield
T-Bond
Aaa
Summer begins (1803) with sharply rising prices and interest rates, which peak at summer's end (corresponding to War of 1812).
Summer begins (1859) with sharply rising prices and interest rates, which peak at summer's end (corresponding to Civil War).
Summer begins (1908) with sharply rising prices and interest rates, which peak at summer's end (corresponding to World War I).
Summer begins (1966) with sharply rising prices and interest rates, which peak at summer's end (corresponding to Viet Nam War).
1800
1850
1900
1950
2000
S&P
PPI

peak on September 3rd, 1929.

?? Foreigners own more than 10% and 30% of all US equities and US treasury bonds, respectively. They are beginning to sell. This is pushing interest rates higher, the dollar lower and is impacting negatively on US stocks as well. Selling generally leads to more selling. This brings to mind similar occurrences in 1929 and 1987.

A Walk Through the Kondratieff Wave Chart:

I encountered an abbreviated version of this Kondratieff Wave graph in 1980. The flaw in that chart was that it estimated the summer peak to have occurred in 1974. This was not the case, because the end of summer is characterized by a blow-off in commodity prices. That happened in 1980. The initial error led to further mistakes including the projected autumn stock market rise, which was assumed to have started in 1976. In fact, the autumn stock market rise of the current Kondratieff wave started in 1981 after the primary recession following the summer peak.

1. A representation of each Kondratieff wave is shown towards the bottom of the graph. The start and end of each of the Kondratieff seasons is shown; as are the primary recessions following the summer peak. These recessions are important because they are the forerunners of the speculative season of autumn.
2. Prices are represented by the Producer Price Index and the Commodity Research Bureau Index (CRB). Unfortunately, data for the CRB is only available since the year 1915. The most important thing to notice about prices is that they rise steeply in each of the Kondratieff summers and peak at summer's end. It is likely that the PPI continued to rise during the autumn of the current Cycle because the Federal Reserve is not restrained by gold which enables the central bank to substantially increase the supply of money. The CRB index did reach a peak at the end of summer in this cycle and has declined through the autumn, which is typical price action in a previous Kondratieff autumn.
3. Two levels of interest rates are shown on the graph:- US Treasury bonds and Corporate AAA-rated bonds. Interest rates rise to a peak in summer and then fall through autumn and winter. Note the spike in rates which occurred during early winter of the last Cycle. This is caused by a credit squeeze. It is probable that the interest rate spike during the coming early winter will be much larger than the spike experienced during the previous winter, because there is considerably more debt outstanding now. This includes US government debt, which at the start of last winter was $16 billion and is now $5.6 trillion and growing.
4. The action of stock prices during the Kondratieff Cycles is represented by the Standard and Poors 500 Index. The major moves in share prices occur to the upside during the autumn and, during winter, to the downside.
5. Gold prices. Unfortunately it only occurred to me after I had commissioned this chart that gold prices should be an important feature of the Kondratieff Wave chart. The price of gold will be included in an updated chart and will be represented by the share price of Homestake Mining. This chart will be made available to readers soon.

This Kondratieff chart was prepared for me by Topline Investment Graphics, a wonderful company with a huge database and a determination to do it properly. That they put up with all the changes that I requested for this chart is a credit to their patience and understanding. I emphatically endorse this company's work and conscientiousness. [Topline Investment Graphics. (303-440-0157)]

The War On Gold: 1931-1999

"For several thousand years, the world has considered gold to be money. For several hundred years, it has lived increasingly on credit and still thought of gold as money. It will take some adjustment to think of paper money as the only money and gold as compared to pork bellies." Business Week, May 19th, 1973.

There is a war being fought between the two international monetary standards. On one side are the proponents of fiat currencies and on the other side are those who believe that the only real money is gold. On the side of fiat currencies are most governments led by the United States, which is fighting to preserve the dominant role of the dollar within the international monetary system. The gold side, on the other hand, is leaderless and confused.

Those bureaucrats who are fighting to preserve the fiat monetary system, which was imposed on the world at Bretton Woods in 1944, are under no delusion. They know that there can be only one victor in this war; paper money or gold. This is why they are fighting so hard to ensure victory for fiat paper. They know that if they lose the war, the world economy will fall into a depression, because the international credit system, which is based upon paper, will collapse, as will all paper currencies. They are all fighting on the same side, and are united in their opposition to gold. Resolute in their resistance, they are prepared to support the leading proponent of fiat paper, the United States dollar. This support is manifested in their collective ownership of some $1.5 trillion in US debt. Despite severe economic problems at home, countries such as Japan and China have refused to sell this debt for fear that such sales would have a devastating effect on the US dollar, which would in turn contribute to a disastrous contraction in the world economy. At present, the world economy is being held by a thread of support, courtesy of a paper-rich US consumer.

At any other time . . . the US dollar would be a currency in serious decline and US interest rates would be soaring.

This foreign support for the US dollar comes neither from any deep love for the United States, nor could it possibly come from a feeling that the US is conducting its fiscal and monetary policy adroitly. At any other time, given the outrageous expansion of the US money supply, its record trade deficit, and despite official assurances of a budget surplus, a growing budget deficit; the US dollar would be a currency in serious decline and US interest rates would be soaring. This international support for the dollar comes from a pragmatic sense of economic self-preservation. However, this foreign support for the dollar is fickle. Economic problems at home will always take precedence over support of a foreign currency. America's two largest creditors, Japan and China, are experiencing increasing economic problems and their continuing support of the dollar may be in question.

The international fiat paper money army wages a typical war, which consists of pitched battles in which gold, amid great fanfare, is sold; and a propaganda campaign is pursued, which is intended to demoralize the gold enemy and throw it into a state of confusion.

This propaganda campaign can be subtle and vicious. It is not beyond the realm of probability that the US has resorted to actual warfare in Iraq and Kosovo, in order to demonstrate its military prowess and thereby enhance international respect for the dollar. Certainly, the US has undertaken a policy of misinformation in order to promote the idea that the United States is fiscally prudent by achieving a balanced budget. This is patently dishonest, but what is propaganda if it is not dishonest? In fact, the US budget deficit year over year 1998 to 1999, ending July, grew $102 billion to $5.616 trillion.

Typically, the propaganda campaign has focussed on the demonetization of gold. In support of this hypothesis some national central banks have undertaken to sell some, and in Canada's case almost all, of their official gold holdings over the past few years. We are never informed of the identity of the purchaser, and for the most part it will have been another central bank, because that would confirm that this particular buyer actually prefers gold to dollars.

Let us put central bank selling into perspective, since the leaders of Paper would have us believe that the majority of governments are sellers of gold. Nothing could be further from the truth. The fact is that in the past ten years only five central banks have sold significant quantities of gold: Belgium; the Netherlands; Australia; Argentina and Canada. Sales by the two European countries were to reduce their debt position, so as to achieve the allowable limits for entry into the European monetary union. Argentina's sale was associated with its currency ties to the US dollar. As for the Australian and Canadian sales, they too, like their European counterparts, were probably associated with debt reduction and a misguided investment strategy based on the US dollar. Net central bank sales during the past ten years have amounted to an average of 320 tonnes a year and since 1970 the total amount of gold held by monetary authorities throughout the world has fallen by just 6%.

Typically, the propaganda campaign has focussed on the demonetization

For its part, the gold side in the current war is in disarray. This side has no generals and the

Central Bank Gold Sales 1989-1998

Source: The World Gold Council.

Country	Amount Sold (tonnes)	Date of announcement	How and when Disposals made
Belgium	127	22-Mar-89	65 tonnes taken by Spanish central bank, balance sold into market through BIS
Belgium	202	17-Jun-92	Sold into market March - early June '92 through BIS and other official institutes
Netherlands	400	12-Jan-93	Mix of spot and forward sales 4th qtr '92, final deliveries Feb '93
Belgium	175	24-Apr-95	Mostly sold into market 1st qtr '95, some thought to be taken by other central banks
Belgium	203	27-Mar-96	Sold into market early '96, deliveries Mar '96
Netherlands	300	13-Jan-97	Sold into market on forward basis latter part '96, settlement Feb and Mar '97
Australia	167	3-Jul-97	Sold into market on forward basis 1st half '97, 125 tonnes delivered June '97, balance Aug and Sep
Argentina	125	3-Dec-97	Series of put options bought earlier, exercised Jan-Jul '97
Czech Rep	25	25-Feb-98	On forward basis during '97, delivery Mar '98
Belgium	299	18-Mar-98	On forward basis over last 6 months '97, delivery Mar '98
Canada	5.2	6-Aug-98	Sold during July
Canada	4	3-Sep-98	Sold during August
Luxembourg	?	4-Sep-98	Amount undisclosed, thought to be around 11 tonnes
Canada	7	2-Oct-98	Sold during September
Czech Rep	31	11-Sep-98	Sold during previous week
Canada	2.1	2-Nov-98	Sold during October
Canada	3.1	1-Dec-98	Sold during November

soldiers are confused. They are fighting a war against a highly sophisticated and motivated enemy, whose sole aim is to destroy the monetary role of gold and impose a fiat paper system on all citizens. This system will allow governments to print money without any discipline and enhance the profitability of their banks. Given the results of many previous wars on gold, which have never been won by fiat money and our understanding of the Kondratieff cycle and its impending winter, during which paper is renounced in favour of gold, we do not give paper much chance of winning this war, despite the disarray on the gold side. But this final battle of the war, which is now unfolding, will be bitterly contested and gold may suffer even more losses before the tide is turned and the paper dollar suffers its ultimate defeat.

The traditional leader on the gold side and again during much of the current war, has been France. In the early 1930's, as the gold standard began to unravel, France began to accumulate gold -- primarily US gold. When the Bretton Woods treaty was formulated in 1944, which was to be the new international monetary model, France delayed her approval to the treaty until she received special concessions from the United States. Even so, France was far from enamoured with the treaty; she believed that it was an Anglo-Saxon conspiracy aimed at promoting the dollar and the pound as the premier international currencies at the expense of all other currencies, including the franc. However, the US dollar was convertible into gold and France took every advantage from 1955 to 1971 to swap her US dollars into gold, and insisted on taking physical possession of the gold rather than entrusting it to the Federal Reserve bank in New York. Between 1960 and 1975, French gold assets were increased by 150%. The leader of this French effort not only to secure US gold, but also to undermine the dollar, was General de Gaulle, who came to power in France in 1958. He was particularly incensed by what he saw as an Anglo-American effort to dominate the international monetary arena. He was jealous that Bretton Woods had placed the pound and the dollar in positions of international pre-eminence and he was determined to see that the system failed. No small part of this jealousy was his veto of Britain's entry into the European Common Market in 1963.

France does not know it yet, but we are at war with

De Gaulle’s attack on the US monetary supremacy was the main goal, and what better way to do this than to swap dollars and pounds for US and British gold? In February 1965, the General attacked the existing Bretton Woods agreement and suggested a new monetary system founded on gold.

"Actually, it is difficult to envision in this regard any other criterion, any other standard than gold. Yes, gold, which does not change in nature, which can be made either into bars, ingots, or coins, which has no nationality, which is considered in all places and at all times, the immutable and fiduciary value par excellence. Furthermore, despite all that it was possible to imagine, say, write, or do in the midst of major events (an allusion to Bretton Woods), it is a fact that even today no currency has any value except by direct or indirect relation to gold, real or supposed." Quoted by Ian Davidson and Gordon Weil. The Gold War. Secker and Warburg, London. 1970. P.92.

If France was the leading proponent of gold at this time, most of the other major European nations with the exception of Great Britain were also busily accumulating US gold. West Germany, for example, increased her gold holdings more than 60% from 1960 to 1975. Overall, France, Germany, Italy, Switzerland, Austria, Portugal, the Netherlands and Belgium increased their combined gold positions over this period by almost 75%. At the same time from 1960 to 1975, US gold reserves decreased 36% and British reserves fell a whopping 67%.

It is interesting to speculate whether the French-led European war on the dollar has merely been postponed until a further opportunity presents itself. Throughout the 90’s there has been evidence of profound French distrust for the US and its world leadership. This

distrust was vividly and astonishingly expounded by French President, Francois Mitterand, who in 1994 said, "France does not know it yet, but we are at war with America. Yes, it is a permanent war, a vital war, an economic war, a war without deaths but to the death. They are very hard, the Americans. They are voracious: they want undivided power in the world. They wanted to send Turks to bombard the Serbs. We have to recall everything they have done for the last 30 years; their propaganda; their manipulations and their lies." Reported by Gartman, Dennis. The Gartman Letter, Wednesday, July 14th, 1999. P.4.
Perhaps it is France's intention to resume the war on the dollar through the Euro, which is 15% gold-backed.

In the expected precipitous decline in the US dollar which should ensue as the Kondratieff winter unfolds, some country, whether it be a united Europe led by France and Germany, or Japan, which is possibly the emerging world power following the coming Kondratieff winter, will assume the leadership of gold. Following the demise of the dollar, which should go hand in hand with the expected US stock market crash, antagonism towards paper assets and the desire for a monetary system that cannot be debased will be worldwide.

. . .antagonism towards paper assets and the desire for a monetary system that cannot be debased will be worldwide

The leadership behind the gold camp must concentrate on demonstrating the traditional role of gold, which is that of money. Those in the current gold camp point proudly to the supply/demand imbalance and view it as the primary reason for an expected increase in the price of gold. They curse central bank sales and central bank lending, which effectively overcomes this imbalance. They view these actions as a concerted conspiracy on the part of central banks and fund managers to depress the price of gold, so that these fund managers can make money on the short sales of gold that they have borrowed and at the same time depress the price of gold, which helps the US-led central banks' war on gold and support of the dollar. It is meaningless to fight the conspiracy, if indeed there is one, because the power of government is virtually unlimited. Anyway, if the central banks were united in their opposition to gold, they could sell off their gold reserves for the next thirty years and that would effectively fill the supply shortage.

A small but vocal group calling itself GATA is resuming the attack on behalf of gold, and rails against the so called collusion of central banks and investment banks, which it says are united in their fight to restrain the price of gold. This is hardly a battle that is likely to be won. Rather, at least as I see it, the battle on behalf of gold should be waged on the inordinate trust that is being afforded the paper dollar and the significant icebergs, which lie just beneath the surface, which could cause fatal damage to this preferred currency.

Why is the fiat currency side led by the United States, mounting another attack on gold? There really is only one answer: If gold remained in the shadows, without attracting attention, the paper money side would be happy to 'let the sleeping dog lie.' But the sleeping dog (gold) has stirred and the US and Britain, the two perpetrators of the Bretton Woods world monetary system, have resumed the attack in order to perpetuate the myth that the dollar is the preferred monetary medium to gold.

Throughout history, any time when a government has resorted to a fiat money system, it has waged a relentless war on gold, in order to convince the population that its paper money is just as reliable as gold itself. However, governments under a fiat regime have always been undisciplined and have inevitably resorted to printing increasing amounts of paper. This invariably leads to inflation. Ultimately, the will of the people to generate trade in a monetary unit which they can trust has always prevailed.

For the first time in the history of money, the population of the world is controlled by fiat money under US dollar leadership. Most international transactions, especially those involving commodities, are undertaken in dollars. The dollar accounts for almost 60% of

And as the smart ship grew
In stature, grace and hue
In shadowy silent distance
Grew the iceberg too.

all currency reserves held by foreign central banks. (Gold accounts for approximately 20% of these reserves). This explains another reason for the disarray in the gold camp. After all, when your own government mismanages fiat money it is reasonable for the people to revolt against that government. When a foreign government mismanages its currency, which can have a direct impact on the wellbeing of citizens in other countries, what can the citizens in those foreign countries do about it? Indeed, do any of them really understand the problem? This is why all governments must support the dollar, like it or not. At the same time, should the dollar disintegrate, the international ramifications will be horrendous.

Gold and fiat money can never co-habit peacefully. Any time a government has introduced paper money and gold or silver concurrently, the specie money has stopped circulating and the fiat money has lost its value. When Queen Elizabeth 1 asked Sir Thomas Gresham what had happened to England's gold prior to her ascent to the throne in 1558, Sir Thomas wrote to the Queen as follows: "It may please Your Majesty to understand, that the first occasion of the fall of the Exchange did grow by the King's Majesty, your late Father, in abasing his coin from vi ounces fine to iii ounces fine. Whereupon the Exchange fell from xxvis viiid to xiiis ivd, which was occasion that all your fine gold was conveyed out of the realm." Attributable to Macleod as quoted in Sutton, Antony. The War on Gold. P.121-122. To this day this is known as Gresham's Law, which simply states that bad money drives out good.

A Short History Of Gold

"With the exception only of the period of the gold standard, practically all governments in history have used their exclusive power to issue money to defraud and plunder the people. What is dangerous and ought to be eliminated is not the government's right to issue money, but its exclusive right to do so and its power to force people to accept that money at a particular rate." Von Hayek, F.A. in a speech in Lausanne, reported in Gold Newsletter, (Vol. 1V, No. 120, Dec 1975.)

Gold usage as a monetary unit has enjoyed a history that spans several thousand years. As early as 1200 B.C the Chinese were using gold and silver as money. An Egyptian's money was gold from 1000 B.C while Babylonians and Minoans also achieved a gold standard that endured many years. The Byzantine bezant, which was coined with a fineness of .95 gold was accepted without question from China to France for 1000 years, or until 1453 A.D. This acceptance of gold amongst so many peoples was attributable to the consistent weight which each coin contained, and the fact that the coins could not be easily counterfeited or debased. What gold did then and has always done is give confidence to those who hold it that it will maintain its value over time and does not represent another's liability. Confidence is key to the acceptance of all money. As we shall see, confidence in paper money is likely to be seriously undermined when the US Long Wave winter gets underway, as it has in most of South America, Asia and Eastern Europe.

The history of the US dollar almost since the inception of the Bretton Woods treaty has been a history of a crisis of confidence. At every point when that confidence has sought to undermine the US dollar's preeminence, the United States government has fought vehemently to preserve the dollar's hegemony. Gold is money, or has been, for at least the past 5000 years. Paper is not money, but merely a substitute, and confidence lasts only as long as people's trust in government is maintained. As soon as this trust is lost, either as a result of government's excessive use of the printing presses, or a breakdown in the government controlled banking system, people flee paper and turn to gold as a store of value. For more than 5000 years every government attempt to introduce paper as money has failed. There are countless stories of these failures. In the 13th century, the Mongolian attempt to introduce paper money in China went down to defeat. About the beginning of the 19th Century, France, England and the United States encountered severe dislocations as a result of their attempts to impose fiat paper monetary systems on their peoples. So unpleasant were their respective experiences that for more than a century thereafter, until the outbreak of World War I, the major economic powers engaged in a full gold standard system. "In general, the nineteenth century witnessed an intellectual environment fully aware of the virtues of a stable gold standard and the vices of paper money." Sutton, Anthony. The War on Gold. P.31.

Three Experiences In Paper Money

The French Assignat: 1787-1796.

This period was typical of what occurs when governments are not subject to the disciplines of a gold standard and can resort to the printing presses at will. Invariably, this results in inflation and the French experience then was no different. The French government was brutal in its imposition of its fiat system. Transactions in gold became punishable by imprisonment and even death. But as inflation grew with the rapidly increased printing of the Assignats, so too, did the civil unrest. The people became increasingly hostile and this ultimately forced the government's hand. In a public admission of failure the government burned all the Assignats and the printing presses at Place Vendome. Combined with the relatively recent debacle of the John Laws paper money experiment between 1716 and 1720, the Assignat experience left an indelible distrust for paper money on the part of most Frenchmen which continues to this day. Rumour has it that French citizens are sleeping with as much as 4 tonnes of gold under their mattresses, and the official French holdings of gold in their reserves are stated at 50.8%, perhaps the largest in the world.

The Continental Dollar: 1775-1792.

The Continental currency issued by the United Colonies in 1775, during the War of Independence, was in direct competition with approximately $10 million in gold and silver coins. This paper currency was directly convertible into the gold and silver coins which for a short time circulated simultaneously. However, the gold and silver coins soon went the way Gresham would have anticipated; they disappeared from circulation and were hoarded. Meanwhile, the Continental bills rapidly depreciated in value and became worthless within six years; hence, the term "not worth a Continental." Typically, during the course of the Continental depreciation, Congress was determined to enforce total acceptance of the Continental currency. Indeed, in January 1776, Congress resolved that, "whoever should refuse to receive payment in Continental bills, should be declared and treated as an enemy of his country, and be precluded from intercourse with its inhabitants." Gouge, William M as quoted by Sutton Antony, P.48.

The bitter experience of the Continental fiasco was not lost on the Founding Fathers of the new Republic, who wrote into the Constitution that individual states must tender only gold and silver coin in the settlement of debt. In 1792, Congress adopted only gold and silver as the backing for the United States monetary system.

The Paper Pound Sterling: 1796-1810.

When Great Britain went to war with France in 1793 the pound was fully convertible into gold. During the initial stages of the war, the drain on gold out of the Exchequer grew at such an alarming pace that by 1796 only £400,000 in bullion remained in bank vaults; down from £7 million in 1794. Moreover, outstanding liabilities had increased to almost £16 million. This dire state of affairs prompted Parliament to suspend the convertibility of paper into gold. What followed was a panic, and people began to hoard gold and silver coin.

The British Parliament, led by Prime Minister Pitt, acted more responsibly than did the French government in its printing of Assignats. Parliament was cautious in overextending government borrowing and contained the growth in the supply of money. British confidence in paper money not convertible into gold was severely impaired and prices of consumer products rose, as did the price of gold itself.
In 1810, Parliament appointed the Bullion Committee to investigate reasons for the increase in the price of bullion during this period. The findings of the Committee were refreshingly candid and concluded: "Inflation is an increase in the money supply. To restrict inflation you look to the note-issuing authority, whether it is a central bank or a government mint, and restrict the note issue. The only effective restriction of a note issue, in light of experience, is convertibility into specie, such as gold and silver". The War on Gold, P.44.

These three stories relate a relatively recent attempt by different governments to impose upon their peoples a fiat paper money system. Like every other attempt in gold's 5000-year history as a monetary unit, these experiments failed. The price of failure for some was far greater than for others, but the end result was that each of the countries resolved to return to a gold-backed monetary system. This system endured with very little upheaval, for more than 100 years.

The War on Gold

Setting the Stage: 1931-1999.

"...The role (for gold) will become smaller, for gold is to be deliberately phased out of the monetary system over the years ahead, completing the process begun in Genoa in 1922." Porter, Sylvia. San Francisco Chronicle, September 27th, 1973.

The beginning of the Long Wave winter traditionally brings a collapse in the international financial structure due to the enormous increase in debt which has occurred during the previous two Kondratieff seasons. Indeed, this winter brings with it the probable collapse of the world monetary system. For example, the mid-1870s winter saw the collapse of the bi-metal monetary system in favour of a pure gold standard in the United States. The previous Kondratieff winter started in 1929 following the crash on Wall Street. Shortly thereafter, the world was thrown into a depression when the international banking system collapsed, which in turn led to the failure of the world monetary system based upon the gold standard.

With the rapid approach of a new Kondratieff winter there can be little doubt that the world will once again encounter financial chaos due to the gigantic debt structure weighing upon the international banking system. As in previous winters, it is likely that this debt will not only collapse the world's banking system, but also result in the demise of the world's monetary system. It is this monetary system that the world's bankers are fighting so hard to preserve.

Alan Greenspan is aware of the impact that a dollar collapse or Wall Street crash will have on this monetary system which so favours the United States. Thus, the US government will do everything it can to ensure that this does not happen. Everything includes not only going to war to demonstrate the might of the US military and ergo, the US dollar, but also buying futures in the stock market to keep it from dropping too rapidly. Moreover, the US Federal Reserve will do every thing it can to prevent a Long Term Capital Management type failure by guaranteeing banks which will assist in the bailout against losses.

Behind the scenes the US government will fight to ensure the supremacy of the dollar within the world's monetary system through secret coercion of governments which might have some dependency upon the United States. An example is Japan, which still relies upon US naval and military assistance in the Pacific. There should be no doubt that as this monetary war nears its climax the fighting will get downright ugly, with no prisoners spared. The failure of the gold standard system at the start of winter during the last Kondratieff Wave is symptomatic of a Long Wave winter. Its failure allowed governments to resort to the printing press as a means to fight the depression. There can be little doubt that the coming winter season will itself contribute to the failure of the current world monetary system based upon a pure fiat floating rate paper money system under the leadership of the US dollar.

Signs of strain in the system are already apparent, with the increasing number of national currency disasters and the serious questions raised about the role of the IMF in its quest to mitigate these disasters. Many see that the IMF's role is to save western banks from paying for their irresponsible lending practices in those countries where currencies fail. After all, the IMF is a Western-led institution, constituted at Bretton Woods, under US and, to a lesser degree, England's leadership.

The majority will choose . . . the discipline of gold over the indiscipline of paper, underwritten by debt and produced by

In most wars, many battles are fought and many casualties suffered before one side capitulates in a state of exhaustion. There have been many wars waged against gold over the past 5000 years by governments wishing to resort to undisciplined increases in the supply of money. Not one of those wars against gold or specie money has been won. The current war on gold is no different and is probably climaxing in the final battle, which will be fought vigorously by those central banks which support the paper dollar. Their objective is to maintain their power to print paper and to incur debt. There can be no doubt that this final battle, which will end the war, will be lost by the central banks when the majority will choose as they have always done, the discipline of gold over the indiscipline of paper, underwritten by debt and produced by government printing presses.

Since the 1930s,we have been experiencing another massive attempt on the part of most governments to impose their collective monetary will upon their peoples through the imposition of a fiat paper money system. There can be no doubt that as in the past, governments will be ruthless in forcing their peoples to accept the unpopular results which such a system invariably creates. The war on gold was declared in 1933 and will continue without compromise until either gold or paper money emerges victorious.

Declaration of War: 1931-1933.

"The death knell for constitutional protections of monetary gold rang in the distance until 1933. There was no mistaking its peal after that year." Sparks, John. The Legal Standing of Gold, essay in 'Gold is Money', edited by Hans F. Sennholz, Greenwood Press, 1975. P.92.

After the First World War, the world reluctantly returned to a quasi-gold standard system; the previous Gold Standard system had endured for more than 100 years. During this time, the world had enjoyed a relatively peaceful existence under the Pax Britannica. International confidence in British financial leadership was the mainstay of a huge worldwide industrial expansion and an enormous growth in world trade. Following the war, Britain lost its leadership role to the United States, which through financing the allies, had assumed the mantle as the world's greatest creditor nation. (A distinction currently enjoyed by Japan, which probably means that world economic leadership will revert to Japan, as the world enters its Long Wave winter season.) As a matter of pride, Great Britain returned to the new gold standard system with sterling valued at the pre-war level of $4.86. This, even though it should have been obvious to Winston Churchill as Chancellor of the Exchequer, that the pound was worth considerably less against the dollar than it had been before the war.

After the Wall Street crash of October 1929, the world financial system began to unravel.

It all started with the collapse of the over extended Kredit-Anstalt Bank in Austria in the spring of 1931, which forced Austria off the Gold Standard. (It is interesting to ponder which bank, in which country, might collapse under the weight of derivatives exposure, or whatever, in the current Long Wave, and thereby act as the catalyst to the collapse of the present financial system.)
Following the collapse of the Kredit-Anstalt Bank, panic spread to Germany whose banks had borrowed over the short term and loaned over the long term. By July 1931, Germany, too, had abandoned the Gold Standard. (If this does not strike you as déjà vu, consider both the yen carry trade and the gold carry trade in the present milieu, in which banks and Funds have borrowed yen or gold at low rates of interest, sold what they borrowed, then invested the proceeds either into high interest-bearing US Treasuries or the US stock market. This type of investment strategy almost caused the demise of Long Term Capital Management. Indeed, Alan Greenspan, following the Federal Reserve bail-out of Long Term Capital, justified intervention in this way. "Had the failure of LTCM triggered the seizing up of markets, substantial damage could have been inflicted on many of the market participants, including some not directly involved with the firm and COULD HAVE IMPAIRED THE ECONOMIES OF MANY NATIONS, INCLUDING OUR OWN." Thus, LTCM almost became The Kredit-Anstalt Bank of the 1990s.)

"All persons are ordered to deliver…to a Federal Reserve Bank… all the gold coin, gold bullion and gold certificates, which they own."
Order signed by President Roosevelt,

Next the world turned its attention to Great Britain, and as gold started to flow out of London, England also succumbed on September 19th. This impacted on all those nations, including the Empire nations which kept substantial reserves at the Bank of England, and they too were swept off the Gold Standard.

In the United States, Americans who were as much worried about the future value of the US dollar as they were about the status of their banks, began to hoard gold. The runs on American banks culminated at the time of President Roosevelt's inauguration (March 4th, 1933) with a bank holiday. At the same time the new President placed a temporary embargo on gold exports. A little later, he issued an order that outlawed the purchase and ownership of gold by US citizens. All privately-held gold was redeemed by the government. By April 20th, 1933, a more permanent embargo on gold exports was instituted and for all intents and purposes the United States abandoned the Gold Standard. War on gold had been declared.

An Uneasy Truce

For several years following this declaration of war, the world entered its Long Wave winter. International trade slowed substantially when every country imposed massive duties on imported goods, to favour internal production. Thus, the world monetary system was not an important factor and in the gold war there was no necessity to fight any battles.

First Battle: The Bretton Woods Convention (1944)

"These paper-versus-gold battles have been fought before. The stark fact is that paper currency and debt money have never emerged triumphant in a straight, head-on battle with gold. Why not? Because gold has tangible worth and is limited in supply. Paper has negligible tangible worth and is unlimited in supply." War on Gold P157-158

By 1944, it was clear that the Allies were going to win The Second World War and so they determined to introduce a new monetary standard for the world after the War ended.

Representatives from 43 nations met in Bretton Woods, New Hampshire, under the leadership of Lord Keynes of Great Britain and Harry Dexter White of the United States, in an effort to formulate a new international monetary system. (Maybe there is something sinister in the two countries assuming the leadership role in this particular venture, since they appear to be in collusion, even today, in the war on gold.) The Bretton Woods agreement appears to be a scheme which provided for a far greater inflation via paper money expansion than the previous gold exchange standard, because only the United States was obligated to maintain its currency at 1% of its par value against gold, which was fixed at $35 per ounce. This would be done by buying and selling gold at that price on demand of any of the other signatory nations' central banks. The United States was not obligated to do this on the demand of any private individual, anywhere, who presented dollars. All other countries were merely asked to fix a par value for their respective currencies against the dollar, but neither were they obligated to maintain this exchange value, nor were their currencies convertible into gold. Either the United States failed to understand the enormous responsibility which it was undertaking by shouldering the entire world monetary system, or it saw this responsibility as part of the veneration of all the other nations, which recognized that a new world leader had replaced Great Britain. In less than 20 years, it became apparent that the responsibility was far too irksome, and the discipline which Bretton Woods imposed upon the United States was too stringent.

The Bretton Woods treaty allows America to take unfair advantage of others, by being constantly in debt to her

Under the auspices of the Agreement, two new organizations were born. One was given the name The International Bank for Reconstruction and Development. This is now known as the World Bank. Its role was to provide loans to countries devastated by the War and to developing nations to assist them in structuring their economies. The capital to finance this was contributed by its members. The format of the World Bank was similar to that of a commercial bank today. It had the responsibility to make loans to countries in need and raise additional funds by issuing debt.

The more important of the two organizations was titled the International Monetary Fund. The IMF is in effect responsible for ensuring that the Bretton Woods agreement functions as intended by its founding members.

The IMF was given the responsibility of fixing the interrelationship of each of its members' currencies. These currencies were supposed to trade within a fixed band, which was to be 1% each side of the fixed par value set against the dollar. Furthermore, the IMF defined acceptable reserves and was to provide financial assistance to nations experiencing short term difficulties in their balance of payments.

Part of the IMF's definition of acceptable reserves were currencies freely convertible with each other and thereby convertible into the dollar, which was itself convertible into gold. Initially, only two currencies were ever considered convertible directly into gold, the pound and the dollar. But the pound, in fact, never really attained acceptance as being either as good as gold, or by inference as good as the dollar, so that the dollar effectively became the currency of choice; a position that it holds to this day, but a position that is under serious attack. That is why the United States is currently fighting so hard to discredit gold.

Each member country placed a percentage of its gold holdings and some of its national currency with the IMF. This created an international monetary pool, which could be used by member nations when they encountered short-term balance of payment difficulties. These loans were called 'drawing rights'. Part of the gold lodged by the member nations is now proposed to be sold in order to help high debtor countries.

For as long as the US could maintain international confidence in the dollar, the Bretton Woods agreement would prevail, but as soon as confidence waned, then the system would begin to unravel.

Second Battle: Waning Confidence in the Dollar (1960-1968)

Throughout the 1960's Washington attempted to camouflage the growing weakness in the dollar through a variety of emergency measures. From 1950 to 1960, the US gold stock declined by 23%, from $22.8 billion to $17.5 billion. By 1960, the US short term liabilities to foreign governments were $18.7 billion, which was 0.5% less than its total gold holdings. In other words, US coverage of its dollar liabilities were 95% of its gold holdings. Only 5 years earlier gold coverage had stood at an impressive 7.8 times liabilities. By 1968, the position had worsened considerably -- gold coverage against liabilities was at a paltry .34. In effect, under the Gold Exchange standard as established at Bretton Woods, the US was technically bankrupt.

Soon after John F. Kennedy became President in 1960, he expressed alarm at the outflow of US gold, which by then was well underway. As he saw it, the remedy was to increase US sales abroad, which would reduce the US balance of payments deficit. President Kennedy was intent upon defending the Bretton Woods monetary system, which had served the US so well. He reappointed Douglas Dillon, whom he inherited from President Eisenhower's Republican regime, to be his Secretary of the Treasury. In support of Dillon was Robert Roosa, who served as Undersecretary of the Treasury for Monetary Affairs. These two men were charged with maintaining the international monetary status quo under US leadership.

"Distrust of paper money surfaced in several countries . . . More and more individuals began to buy gold as a more reliable store of wealth."

Dillon and Roosa endeavoured to preserve the Bretton Woods agreement in two ways. Firstly, they induced the IMF members to make additional contributions to the Fund. This was achieved by giving the European Nations an increased say in IMF operations. In addition to this increase in quotas, the IMF added to its available currency holdings by selling some of its gold.

Secondly, and perhaps more importantly, the Group of Ten was formed to ensure the viability of the IMF lending programme. The Group of Ten in essence consisted of the ten largest world economic powers and was undoubtedly a forerunner to the present Group of Seven.

The International Gold Pool

As gold increasingly left Fort Knox and moved into the vaults of many European Central Banks and the US balance of payments continued to deteriorate during the 1960s, it became obvious to sophisticated investors, which included the European banks, that the price of gold at $35 per ounce was undervalued. In 1960, gold in the free market in London hit $40.60 an ounce. "Distrust of paper money surfaced in several countries -- repeating the age-old historical lessons revealed by the French assignat, the Continental Bill, and countless other extinct currencies. More and more individuals began to buy gold as a more reliable store of wealth." The War on Gold, P108.

In an attempt to cap the price of gold, The London Gold pool was formed in 1961 under United States leadership. In addition to the US, members were the United Kingdom, France, West Germany, Switzerland, Italy, Belgium and the Netherlands. The United States controlled 50% of the pool's operation. The objective of the 'Pool' was to keep the price of gold fixed at $35 per ounce. To achieve this objective the 'Pool" sold gold when the price rose above $35 per ounce and bought gold when the price dropped below $35 per ounce. The 'Gold Pool' soon had sold gold valued at $991 million from the stocks of the member countries. By 1967, France withdrew from the 'Pool', rather than risk the loss of any further gold. The United States assumed France's share in the operations, which increased US participation to 59%. Even before she withdrew from the agreement, France had become an aggressive accumulator of gold. In 1966, France increased her gold holdings by US $601 million, whereas the US lost $571 million.

As the demand for gold continued to escalate, the 'Pool' was forced to sell even larger amounts of its gold holdings. Indeed, between November 1967 and March 1969, the US lost an enormous $3.2 billion of its gold reserves. On March 14, 1968, 400 tons were purchased from the 'Pool's' fund by private investors. Enough was enough! Other European Banks then followed their French counterpart by withdrawing from the 'Pool', which effectively left the defence of the $35 gold price to the United Kingdom and the United States. However, the battle was over; the US had lost 20% of its gold within five months and surrendered this battle against gold when President Johnson asked the Bank of England to close the Gold Pool operation.

The Drain on US Gold

As long as the US dollar was exchangeable into gold at $35 per ounce, Gresham's Law prevailed, as European Central Banks turned their paper dollars into gold, which then was hidden within the Banks' vaults where it remains, for the most part, to this day.

During the 1950s, the world confidently viewed the US dollar as being as good as gold. Towards the end of the Eisenhower presidency, this confidence in the dollar began to wane due to a growing deficit in the US balance of payments. In conjunction with this concern for the US dollar, foreign governments started to exchange their dollars for gold at an accelerating pace. At the beginning of 1960, US gold reserves were $19.5 billion. By the end of that year they had dropped to $17.8 billion. By 1970, these gold reserves had dropped to $10.1 billion -- approximately 1/10 of US liabilities. There was no way that the US could meet these foreign liabilities in gold, as it was required to do under Bretton Woods and for the US there was only one course left open.

Third Battle: President Nixon Repudiates Gold (August 1971)

"Gold is a universal and timeless money, unexcelled as a store of value, usually available only to those who will yield scarce resources to gain it. Paper money and debt money, by contrast, can be easily created. With a fiat paper-money currency, power can be created by whomever has the legal monopoly of the creation process. Who owns the paper factory controls the system. Paper money or debt creation is flexible, infinitely expandable, ersatz money. It is precisely this ersatz quality of paper and debt money that makes it politically useful and desirable to power brokers. It can be manipulated. Gold cannot be manipulated politically, therefore it is unusable and undesirable". The War on Gold, P. 201.

. . . the US and its junior currency partners have attempted to convince everyone that gold is irrelevant in the international monetary system..

When President Nixon ended the convertibility of the dollar into gold, he was admitting that the US had lost the first stage of the War on Gold. Given the enormous outflows of US gold during the preceding decade, it had become futile to pretend that the dollar was as good as gold; the evidence pointed to the contrary. The significance of this decision was that the world was now on a pure fiat monetary system in which international currencies would float in value one against the other. There was now absolutely no international system of monetary control. Countries which were facing economic hardship could resort to the process of currency devaluation and they have resorted to this tactic with abandon following President Nixon's decision. During the next stage of the war on gold, the US and its junior currency partners have attempted to convince everyone that gold is irrelevant in the international monetary system.

The Fourth Battle: Attempts by the IMF and the US Government to Suppress the Price of Gold (1970s)

"You can fool all the people some of the time, and some of the people all the time, but you cannot

fool all the people all of the time." Attributed to Abraham Lincoln speaking at Clinton, Sept.8, 1858.

In December 1974, the United States removed the ban on gold ownership by US citizens, but at the same time began a huge propaganda campaign against the ownership of gold. This included the much-publicized gold auctions, which were aimed at deliberately depressing the price of gold. It is interesting to note that this is the same tactic which is now being employed by the much publicised gold auctions, spread over many years, which have been announced by the Bank of England and the IMF.

On January 1, 1975, the US offered 2 million ounces of gold for auction, receiving bids for less than half the amount. Not surprising, given the fact that this auction was for gold in unacceptable delivery form. In other words, the US gold to be sold was .995 fineness, compared to the international acceptable delivery standard of .9995. Nor was this auction open to foreign central banks, which would lead one to conclude that either the US did not have the gold in good delivery form or, it wanted to ensure a low bid, to drive the price of gold lower.

Kondratieff Autumn is always the season in which investment in paper, be it stocks, bonds or other forms of debt, reaps the biggest

In 1978, the US gold auctions resumed and were ended in 1979. Through this period, the US auctioned approximately 530 tonnes or 17 million ounces.

At this time, the IMF also rose to the occasion to sell part of its gold holdings. The first IMF auction was held in June 1976 and 25 million ounces were sold (the same amount that is being offered at each of the British auctions). There were 45 IMF gold auctions in all, and the last one was held on the 7th of May 1980. During this time, the IMF disposed of some 778 tonnes of gold at an average price of $240 per ounce.

Was the US so impecunious, that in conjunction with its affiliate, the IMF, it had to raise money through a series of gold sales, which realised nothing like the eventual price of gold; or was it determined to try and restrain a rising gold price? Given the paltry returns that the US and the IMF received at these gold auctions, the intention could not have been one of deriving income, but rather to suppress the price of gold.
In that endeavour the US failed miserably. Ultimately, the price of gold peaked in January 1980 at $850 per ounce.

Interregnum: Kondtratieff Autumn (1980- 1998)

Following the determined, but unsuccessful battles against gold which were waged throughout 1970s, a period of relative calm ensued which has continued throughout the Kondratieff autumn. This is because the Kondratieff autumn is always the season in which investment in paper, be it stocks, bonds or other forms of debt, reaps the biggest rewards. During this season, there is no necessity for paper money to continue the war, because paper is the supreme asset. Thus, even though gold prices reached $500 per ounce in 1987, the war against gold was muted. So now that gold prices have dropped below $300 per ounce, why has the war against gold been resumed?

The answer quite simply is that the world's central banks realise the gravity of the world economic situation. Paper assets are ridiculously overvalued and a US stock market crash could come at any time. Gold is once again becoming the investment of choice.

Preparing for a Resumption of War

A usual start to a Kondratieff winter is a stock market crash, which is followed by the disintegration of the credit system and an economic depression. Since President Nixon abandoned the gold standard in 1971, the world monetary system has been based entirely on paper money. Typically, central banks unhindered by the discipline of gold have resorted to printing money to fuel the inflationary fervor in the investment markets, particularly the stock market. This is especially true of the US Federal Reserve Board, which has, through a huge expansion in the money supply, propelled the US stock market into the equivalent of Caesar's Palace in Las Vegas. This makes the stock market situation far more perilous than even 1929, because at that time the Federal Reserve was restricted in its ability to print money by the gold exchange standard. Stocks are simply another form of paper, albeit based upon some underlying asset value, but these stock values are at levels never seen before in the history of the stock market, and have no relevance to the underlying asset, which they are supposed to represent. Alan Greenspan is acutely aware of his Pandora's box and will do everything that he can to prevent a stock market crash. He knows that a US stock market crash is the precursor to the ultimate defeat of all paper assets, including the US dollar. Thus the war on gold has been resumed to divert attention away from the acute vulnerability of paper assets, particularly the US stock market and to forestall wise investors who have already begun to accumulate gold.

The Fifth, and probably last, Battle (1998-2000)

"Historically, wars on gold have been associated with tyranny and totalitarian grabs for political power. When gold coins circulated freely alongside paper money (as occurred with the Continental bill and the Greenback in the United States and the British Paper pound of 1797), gold will be valued more than paper money. Following the inexorable law of the marketplace the paper currency will be placed at a discount. But when political power base is threatened by these superior competitive characteristics of gold, too often the paper money or debt is declared as the only legal money, to the exclusion of gold (e.g., the cases of the Kublai Khan, John Law's Banque Royale and the Federal Reserve dollar). Sooner or later in the war on gold, physical coercion must be used to impose such a politicized fiat money on an unwilling citizenry." War on Gold PPs 199-200.

It was the Long Term Capital Management debacle which was the catalyst for central banks to resume the war on gold because at that time Alan Greenspan recognised that the world's financial structure had been placed in jeopardy by the overzealous investment strategies of LTCM. At the same time, for those who understood how the world's financial system stood in the balance, the time arrived to reinvest in gold as the money of last resort. And so the demand for gold increased and the price of gold shares, in anticipation of further increases in the price of gold, appreciated almost 100% in a little more than two months during the Fall of 1998.

The increased demand for gold is due to renewed fears about the stability of the US financial system. It is merely a precursor to the huge demand for gold that will erupt worldwide when the enormity of the US asset bubble is revealed by the subsequent crash.

This initial increase in the demand for gold was the signal for the central banks, led by the US, to renew the war on gold. In a typical unoriginal fashion, the same strategy which had failed so miserably in face of rising gold prices during the 1970s was re-introduced. This time the central bank chosen to lead the attack on gold was the Bank of England. (Is that because the US has no gold to sell? See below)

Near the end of 1998, Gordon Brown, the British Chancellor of the Exchequer, proposed that the IMF should sell up to 10 million ounces of gold with the noble intention of using the proceeds to help heavily indebted countries. This is the same reason used for the IMF sales in the 1970s. The trouble with this plan was that many of the countries the IMF was supposed to be helping relied on gold mining as a major source of income. The proposed sale has encountered increasing opposition in the US Senate. With the IMF sale in jeopardy, another central bank had to step up to the plate.

Good old Gordon Brown came to the rescue of paper again. This time he proposed that Britain herself would do the selling. In all, Britain proposed to sell 415 tonnes of its total gold holdings of 715 tonnes (58%). 25 tonnes would be sold each quarter, starting in July of 1999. Undoubtedly, the purpose of the British announcement was to inflict the greatest amount of damage to the price of gold on the basis of a relatively small-scale sale. To this point, that objective has been very successful.

It is important to understand why such a relatively small sale of gold has had such a negative impact on the price of gold. In comparison, Belgium sold 203 tonnes in 1996. In 1997, the Netherlands sold 300 tonnes and Belgium sold an additional 299 tonnes in 1999. In each of these years there were sales from other central banks as well. The gold market scarcely shuddered. These sales were conducted in secret and were only reported long after the fact, whereas the intended British sales have been accompanied by much publicity so as to have the largest detrimental impact on the price of gold. Moreover, the British government could be confident that its announcement of sale would be viewed more negatively than most other central bank sales, because:-

?? Britain was the first member of the G7 nations to sell a portion of its gold position.
?? The amount of British gold to be sold was almost 60% of her entire holdings.
?? Britain has been seen as a world leader in the international monetary system.
?? Britain had led the world in the gold standard system which endured for 100 years, until the outbreak of World War 1.
?? The Bank of England has acted as custodian for much of the central bank gold.
?? When the British sales are completed, her gold holdings will amount to a paltry 300 tonnes, which is a little less than the gold reserves of Venezuela. As a percentage of total reserves the British gold holdings will drop to less than 7.5%, equivalent to the gold reserves of Equador and Albania.
?? The proceeds of the British sales were to be invested, in what the British government deemed 'more appropriate investments', which included the paper debt of Japan, Europe and the US. Thus the British government is making the statement that it views paper a more desirable monetary asset than gold.

Ms. Haruka Fukuda, Chief Executive Officer of the World Gold Council, views the British gold sales as part of an Anglo Saxon conspiracy to promote the dollar. She said, "despite persistent efforts by the United States to expel gold from of the international monetary system entirely, gold is today an important part of the world's central banks' official reserves." (http://www.gold.org May/June 1999) Extending beyond Ms Fukuda's remarks, the World Gold Council hypothesizes, "In linking the Americans to this BOE decision, Ms Fukuda fleshes out our assessments, implicitly suggesting an ideological battle between the Anglo-American camp on the one hand, and the Continental Europeans on the other." Ibid.

So, is the grand scheme envisioned by General de Gaulle, of a world monetary system governed by a gold standard -- but this time under the leadership of a Europe led by France and Germany -- already taking shape? And has this Europe declared a silent monetary war on the leaders of the paper currency union, America and England?

Certainly, the Banque de France in its latest annual report has reinforced not only its commitment, but a European commitment to gold; "Neither the US, Federal Reserve nor the Deutsche Bundesbank nor the Banca d'Italia, nor of course the Banque de France, are considering selling gold." (http://www.gold.org -June 24, 1999. P.5)

For his part in testifying before the House Banking Committee with Mr. Rubin, Mr. Greenspan, speaking strongly in support of not selling any of the US gold reserves, said: "Gold still represents the ultimate form of payment in the world. Fiat money in extremis is accepted by nobody. Gold is always accepted and is perceived to be an element of stability in the currency and in the ultimate value of a currency." We would comment to this: What hypocrisy, Alan, but how true!

Central Bank Gold Loans

"The whole herd of swine ran violently down a steep place into the sea, and perished in the waters". St. Matthew, viii. 32.

There is a new dimension in the war on gold; one that that might be out of hand, which has the potential to instigate panic buying. This is related to gold loans by many central banks, which are made at nominal rates of interest. No-one knows for sure how much gold has been loaned, but some estimates put it at 10,000 tonnes, which is approximately four years of mine supply and one third of the gold owned by central banks. The gold borrowers – banks, hedge funds and gold mining companies – sell the borrowed gold and invest the proceeds into assets which produce much higher returns than the paltry interest that must be paid on the loan of gold. This is almost a carbon copy to the 'yen carry trade', which was to borrow yen at low interest and invest at high rates of interest or at potential high rates of capital gains. This type of hedge strategy, but for the interference of the Federal Reserve, would have bankrupted LTCM.

The gold which has been borrowed has apparently already been sold into the market. If true, it is surprising that the price of gold has been as robust as it has, because the annual deficit between demand and supply is a not-inconsequential 800 to 1200 tonnes. However, 10,000 tonnes dwarfs that amount and such an enormous supply should have had a very negative impact on the gold price, unless of course, some central bank stepped in to buy it all.

According to the office of Comptroller of the Currency, US banks have a gold derivative exposure valued at $65 billion. It is probable that much of this position is short the actual commodity. $33 billion is scheduled to be covered in the next six to nine months and this equates to approximately 100 million ounces (3000 tonnes) or more than one year's production and considered less than annual demand.

"He who sells what isn't his'n, buys it back or goes to prison."

Stock Market Adage

The danger for the short sellers of gold is that they will eventually be forced to repurchase the gold that they have sold and repay it to the central bank from which they originally borrowed. The problem with shorting gold is that there is only a finite amount produced each year – currently, about 2500 tonnes.

For the hedge funds which have borrowed the gold and sold it, everything works well as long as the following situations continue:-

- Gold prices remain below the level at which gold has been sold short.
- Yield levels on the bonds that have been purchased with the proceeds of the gold sale remain at or below a nominal rate of interest at the time that the proceeds were used to purchase bonds.
- If stocks were purchased with the proceeds, then stock prices continue to hold their value.
- The interest rate associated with the cost of borrowing the gold does not rise. (Note that these rates have now risen to 4.8% which raises the cost of borrowing gold close to the yield on US Treasuries).

As you can see, this allows a number of variables into the equation which are beyond the control of the original gold borrower. If, however, the borrower knows that the central bank will do its utmost to ensure that these four things happen, the game becomes much easier and the likelihood of profits virtually guaranteed. This is what GATA is fighting against.

The Federal Reserve Board is indeed supporting this gold short position, the extent of which must have been apparent to Mr. Greenspan, following the bailout of Long Term Capital Management. At that time Mr. Greenspan said "Nor can private counterparts restrict supplies of gold, another commodity whose derivatives are often traded over-the-counter, where central banks stand ready to lease gold in increasing supplies should the price rise." Mr. Greenspan's statement has given the green light to hedge fund managers, who feel that they have been given carte blanche to borrow gold and then sell it and use the proceeds to buy investments with better returns. But when the majority of hedge fund managers adopt similar tactics, the short position in gold becomes excessive, particularly so given the limited amount of physical gold that is available to offset these short positions. Since all short positions ultimately have to be covered, the huge short position in gold is setting up the probability of a major financial mishap. Gold paper claims in the form of derivatives far exceed the underlying physical asset on which they are based.

How Much Gold is in America's Vaults?

"The cruelest lies are often told in silence." Stevenson, Robert Louis.

Is the United States waging a war on gold for a more sinister reason than just promoting the US dollar as the leading currency in the world's fiat paper money system? Is there little or no gold backing the dollar? In spite of official US assurances that there are 8138 tonnes of gold in support of the dollar, there has not been an official audit of this gold since the Eisenhower presidency, and successive US presidents have refused to allow such an audit.

Rumour has it that President Johnson sold all the US gold holdings in a bid to deflate the price of gold, which was rising against the dollar. The British government was said to be in collusion with the United States and was supposed to assist the US in repurchasing its gold at lower prices following the US gold sales. According to the rumour, all the US gold was bought without the price ever dropping below $35 and Britain and the US were unable to repurchase the US gold. Supposedly it was for this reason that President Johnson failed to seek a second presidential term.

In support of this rumour, James Turk writing in his publication, Free Market and Gold Report, cites the following:-

- The gold auctioned by the US during the 1970s was not in coin melt quality, because all the gold in 'good delivery' had already been sold. According to Mr. Turk's sources the gold sold at these auctions was all that was left in official US vaults and was the citizens' gold confiscated by President Roosevelt in 1933.
- W. Gordon Tether a long standing business and economics reporter of the esteemed Financial Times of London was inexplicably fired by the newspaper after he had reported that the US government had secretly sold its entire official gold reserve. Turk, James. Free Market and Gold Report, 25th April, 1994.

Now we can add new evidence in support of this rumour. Why was the British government inveigled by the US to auction more than 50% of its gold reserves in support of the dollar? The British sale of 415 tonnes (58% of British gold reserves) would equate to little more than a paltry 5% of the official US gold holdings and would no doubt have had, at least, the same effect, as the announced British sales, on the price of gold. The US was quite willing to sell gold in the 1970s in support of the dollar and that begs the question; why not now?

When the US declares that it will not sell any of its gold, is it because it has no gold to sell?

War Ends: Victory for Gold ? (1999-2000)

"Looking back over monetary history, we see that gold has always been prominent as a protector of individual sovereignty. Private gold ownership is inconsistent with the aims of dictatorship; a war on gold is a necessary concomitant to centralized political power." War on Gold P. 200

In at least two issues of the Long Wave Analyst, we have shown the sequence of events of the 1930s credit crisis as shown by Donald Hoppe. We think that a very similar set of events is already occurring as the present credit crisis begins to unfold and therefore it is important to bring these events to your attention one more time.

1. Flight from questionable securities into stronger securities;
2. Intense liquidation of inventories and commodities ;
3. Flight from weak currencies into stronger currencies;
4. Flight from bank deposits into cash and gold;
5. Flight from strong currencies into gold.

Clearly, we have already completed the third stage of this sequence, with the US dollar being the primary beneficiary. There is some compelling evidence that stage 4 is already in progress. In its most recent report the World Gold Council reported that gold demand in the 2nd quarter of 1999 was a record 810 tonnes. Significantly, while jewelry demand was up 13%, investment demand increased 32% over the same quarter last year. Investment demand in Japan was up 171% over the same quarter last year, which included a two week period in June in which Japanese investors purchased 8 tonnes of the precious metal, which was approximately 47% of the total purchased in the entire quarter. In the United States investment demand increased 76% from 1998. “Continued concern over a possible reversal in the stock market was the main reason cited by purchasers for the strength of gold investment.” (World Gold Council) Stage 4 will intensify in the event of a US stock market crash, which followers of Kondratieff would believe is inevitable. Stage 5 will occur as the ramifications of the stock market crash become apparent. This would include the disintegration of the US credit bubble and the plight of the US banking system.

The Plight of Paper

“Who needs gold when we have Greenspan.” New York Times headline as quoted by Bell, Andrew. The Globe and Mail, July 31st, 1999.

It is precisely because of Alan Greenspan that we do need gold. Mr. Greenspan, as head of the Federal Reserve board, has orchestrated through a low interest rate policy and unprecedented monetary growth, the greatest stock market bubble in history. This bubble threatens to destroy the entire world financial system. Unfettered by the constraints of a gold standard system, Mr. Greenspan is responsible for an enormous expansion in credit, which has fueled the speculative excesses that now pervade the US capital markets. He is revered by these speculators who are financially benefiting from the rising markets.

While they praise Mr. Greenspan now, these same speculators will vilify him when the stock market bubble bursts and they are left with nothing but memories or dreams of wealth.

Most economists pay little heed to this monstrous expansion in the money supply, because it has not translated into the usual price inflation. What they fail to see is that this monetary growth has created inflation in the investment markets, particularly the stock market which is a bubble but, like all bubbles, invisible to those inside. The rise in the Dow during the present autumn of the Kondratieff Cycle is almost three times bigger than the gain made by the Dow between 1921-1929. The crash which followed that bubble reduced the value of stocks to one tenth of the value that they had been at the 1929 peak. It is probable that the crash of the current stock market, which will herald the Kondratieff winter will be every bit as large as the crash of 1929-1932.

Traditionally, the autumn period of the Long Wave is the season of rising speculation, particularly in the stock market. Why stocks? Because it is an asset class that is affordable by most people. Shares are highly liquid; that is, easily transferable. For the most part, investing in shares requires little or no knowledge; just open an account with a stockbroker or buy an equity mutual fund. Now, of course, as the stock speculative bubble reaches unprecedented dimensions, stockbrokers and equity mutual funds are de classé. Everyone is now an expert and the day of internet trading is the vogue. Who needs a stockbroker or a mutual fund manager, when all that is required is a little reading and an on-line stock trading account? After all, stocks do nothing but go up ad infinitum. Every reversal is simply a buying opportunity for a further gain.

The outcome, however, is unlikely to be any different from that which speculators experienced at the onset of the previous Kondratieff winter and the Wall Street crash that precipitated it. “Mrs. Clare…took to speculating….At the peak of stock prices she might have sold out for close to a million, but she could not let go…. And in the end lost everything, even her home… She was in the grasp of the spirit of a mad time, when even men deemed ‘wise’ talked of a New Era…” Pound, Arthur. Atlantic Monthly, 1932.

“Accessible now to anyone with an Internet connection and a credit card, the stock market has become a universal distraction, a sanctioned narcotic. You are either plugged into it or made constantly aware of how foolish you are not to be. In hospitals and schools, in dens and kitchens, the amateurs are mainlining stocks. They have one eye on their day job and the other on their stock portfolio, posted in red and green on their computer screens. Once a barometer of the country’s work, the stock market now is another way to play.” Puamgarten, Nick and Spitz, Tinker. National Post, Saturday, August 28,1999. P. B1.

According to an SIA/Investment Company Institute survey, nearly 50% of US households own stock which is massively higher than the estimated 21% in 1929. A quarter of all US assets, almost $11 trillion, is invested in the stock market. 6.3 million Americans trade online and since last year approximately $10 trillion of US shares have traded on the NASDAQ and New York Stock Exchanges. Trading has become a US fixation and celebrities like Barbara Streisand are now courted for their investment acumen. Many Americans have quit their jobs so that they can devote their undivided attention to trading the market. Many others, while maintaining their jobs, are devoting a huge amount of their working time to trading. An executive at a US real estate investment firm said, “everyone here just trades all day….It gets to the point were you feel like a loser if you’re not playing the market.” Ibid. P.B2.

How would you like to put your good health in the hands of this doctor who said, “I trade between patients…. I’ve been trying to get the anesthesiologist to replace the EKG monitor with a ticker, but we don’t know if that’s going to fly.” Ibid. P.B2. There are countless stories like these that demonstrate the extent of the bubble that goes by the name of the stock market in America. There are usually signs, not always recognisable at the time, which lead to the stock market crash presaging the winter of the Kondratieff Cycle, and the collapse of paper assets.

Setting the Stage for the Stock Market Crash

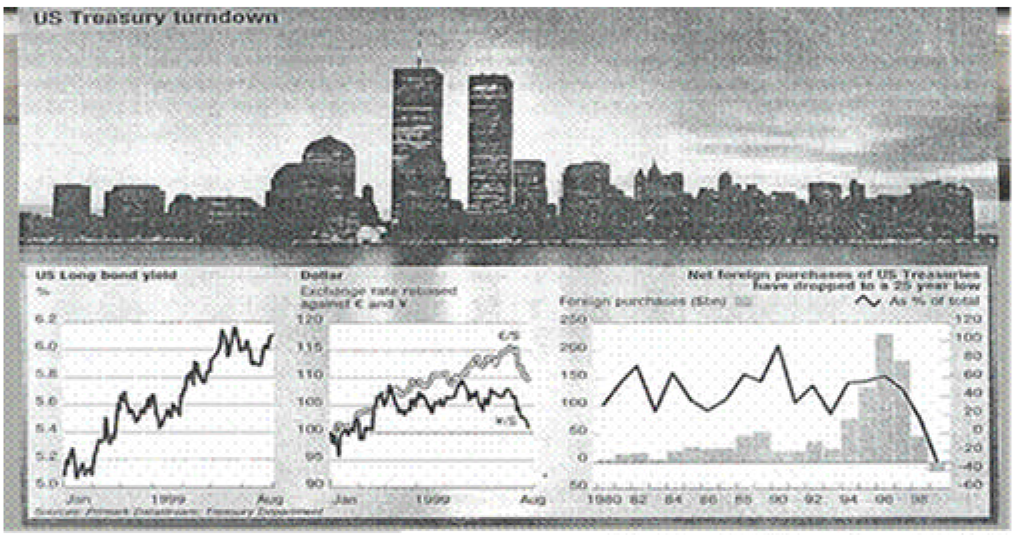
“A sad tale's best for winter.” Shakespeare, William

Most bear markets are caused by rising interest rates. Mr. Greenspan understands this and that is why he has been somewhat reluctant to reverse the three interest rate cuts he instigated last year following the 20% correction in the stock market. But the Federal Reserve Chairman is caught between a rock and a hard place. On one hand, if he raises rates to dampen speculation in the stock market it could lead to a stock market crash and, following that, very difficult times for the US economy; on the other hand, a failure to raise rates will lead to a fall in the value of the US dollar. So Mr. Greenspan has opted to raise rates in a series of incremental increases, a quarter of a percentage point at a time. Undoubtedly, he desires that such small and well-telegraphed interest rate hikes will effect a gentle reduction in stock market values and at the same time inflate the value if the dollar which should, or at least he hopes it should, restore foreign buying into the US Treasury and stock markets.

While Mr. Greenspan has the power to manipulate short-term interest rates, long-term interest rates are set by the market and these rates have risen considerably since they bottomed last October. From a low of 4.75% at that time, they have reached as high as 6.25% recently and it now appears that they are going to go even higher. 7% could be the next level which would almost certainly be too much to bear for the highly inflated stock market. Although it is probable that increasing rates have already started to impact negatively on stocks.

The problem for the US is that it is now the largest debtor nation in the world and as such is dependent upon foreign creditors. If these creditors fear either that US rates will rise or that the value of the dollar will decline they will withdraw their credit and US rates will begin to rise. Worse still, if they begin to sell their substantial positions in US debt because of these same fears, US interest rates will have to rise dramatically.

The Financial Times of London recently wrote, “foreigners may finally have had their fill of Uncle Sam’s IOU’s.” The article went on to say that even before the recent fall in the US dollar that began in July it had become apparent that the foreign appetite for US Treasury debt had been in decline and that in the first quarter of this year foreigners became net sellers to the tune of $17.3 billion.



The Financial Times, August 3, 1999

So, what is now occurring in America is similar to the experience of 1929; that is, an increase in interest rates and a withdrawal of foreign capital. These two circumstances were instrumental in the Wall Street crash of October 1929. Will it be any different this time? We doubt it. After all, the Kondratieff winter invariably starts with a stock market crash. It is the crash of US stocks which will lead to the destruction of the US dollar and start the Kondratieff winter. The Kondratieff winter will ensure the destruction in value of all paper assets and other investments whose values compounded on a mountain of credit during the Long Wave autumn. This devastation in the value of paper assets will ensure the victory for gold. The sole purpose of the Kondratieff winter is to rid the economy of the unsustainable level of debt built into the economy throughout the three previous Kondratieff seasons. This purging of debt allows the economy to start afresh at the onset of spring. Thus winter is invariably the season of deflation and depression.

Gold enjoys two seasons in a Kondratieff year, summer and winter. Summer is the season of inflation; and inflation simply erodes the value of paper money. Gold rises in sync with this decline in the value of paper. On the other hand, paper assets including paper money are destroyed during winter and the value of gold soars, because there are no alternative choices for money.

In the following table we have suggested a possible sequence and timing of events in the US capital markets, based upon our interpretation of the US position within the Kondratieff Wave.

Event	Time
Foreigners begin to liquidate their US debt holdings (@$1.5 trillion)	Already begun
US dollar falls	Already begun
US interest rates rise	Already begun
Foreigners intensify their sales of US debt	Beginning
Gold shares rise anticipating gold metal price increase	Beginning
US stock markets start to fall	Beginning
US dollar begins a more rapid decline and US interest rates begin steeper increase	Sept/Oct1999
Foreigners increase liquidation of US stock positions	September 1999
US stocks crash	Sept/Oct 1999
Dollar crashes; US interest rates sharply higher	Sept/Oct 1999
Major worldwide move to gold. Gold price and gold share prices move sharply higher	Oct/Nov 1999.
US in Kondratieff Winter Deflationary/depression begins	January 2000
Worldwide monetary crisis caused by US dollar debacle	February 2000
Gold and gold share prices move to new highs	Feb/April 2000.

Kondratieff Autumn and the Debt Bubble

"Wilt thou seal up the avenues of ill? Pay every debt, as if God wrote the bill." Emerson, Ralph Waldo.

It is debt which finally destroys the economy and that debt assumes massive proportions during the Kondratieff autumn. This time the debt at least within the US economy has reached astronomic levels, which have been fueled by a Federal Reserve Board, unfettered by gold, adding copious amounts of money to the economy. The US total debt now is in excess of $20 trillion; couple that with a negative amount of consumer savings and you have a recipe for financial disaster.

Consumer non-mortgage debt in the US has increased 70% or $565 billion to $1.4 trillion since 1992. Over the same period household mortgage debt has grown 50% to $4.2 trillion. Overall, household debt is now close to 75% of GDP versus 47% at the beginning of the Kondratieff Autumn. Stuart Fieldstein, President of SMR Research, a credit research company, recently wrote that, "These figures aren't pretty…. However, you look at it, about one third of all households are broke." (www. prudentbear.com)

The same is true for American corporations who have also been on a debt binge, which now translates to $3.7 trillion. This debt is growing exponentially on the back of stock buybacks and corporate mergers.

Perhaps most troublesome of all is the huge increase in margin debt that is up 300% since 1995 and now stands at $176.9 billion. In addition to this margin debt is the unmeasured amount of debt that households have accumulated through home equity lines of credit and second mortgages that have been invested in the stock market.

All of this debt however pales in comparison when measured against the derivative exposure accumulated within the financial markets. Derivatives are in their own way similar to margin debt because they allow a relatively small amount of money to control a significantly larger amount of value in the underlying asset. Worldwide derivative exposure is estimated to be a mind-boggling $100 trillion. In the United States the seven largest banks have $33 trillion of derivatives on the books– the majority of which are related to the credit markets. $29 trillion of these positions are over the counter, meaning that these trades are not subject to government or exchange regulation. What is more frightening is that this enormous speculative position is covered by a paltry $460 billion in equity capital and 40% ($13 trillion) is not offset, or in derivative parlance, is "naked". For every derivative position taken on one side of the market there is another on the other side. This means that one side or the other has made the wrong choice and stands to lose everything. The majority of the interest rate derivative exposure of the large US banks is probably on the short side of bonds in order to protect their large exposure against rising interest rates (although this exposure cannot be anywhere near the amount that they are supposedly hedging). On the long side are, probably, the largest US brokerage firms and there is no way that they will ever to be able to meet their obligations in the face of rising US rates -- and they are rising.

The pervasive debt which stands as the edifice of the US financial emporium has made it a house of cards, which threatens the entire US financial system. The debt bubble invariably bursts at the beginning of the Kondratieff winter and this leads to deflation and an economic depression.

Notional Derivative Exposure of Major US Banks (ContraryInvestor.com)

BANK	Total Assets	Total Derivatives	% OTC Contracts	% Interest Rate	% Foreign Exchange	% Credit Exposure to
Chase	$296.7	$10,261.5	93.5 %	78.9 %	19.7 %	380.3 %
JP Morgan	175.8	8,653.6	79.8	82.9	13.1	820.3
Citibank	300.9	3,625.3	95.0	43.1	53.7	202.5
Nationsbank	317.1	2,700.9	64.0	94.9	3.0	80.8
Bankers	104.6	2,524.1	93.5	66.2	30.2	472.7
B of A	257.5	1,870.2	89.1	62.3	36.6	90.3
First Chicago	74.2	1,421.2	94.7	82.8	16.5	219.5

The bursting of the US stock market will lead to the destruction of the debt bubble and all paper assets, including the US dollar. At this stage the victory for gold will be complete.

Kondratieff Cycle as an Investment Guide

We live approximately through one complete Kondratieff Cycle. It is for this reason that most of us have little understanding about where the economy is going, because we have not lived the experience. Students of the Long Wave can turn their knowledge into experience, which affords them a huge advantage over economists and investment advisors. Even though very few of us have lived through the previous Kondratieff autumn (1921-1929), we can still extend our knowledge of that period and compare it to the present autumn and see the many similarities that exist between them. As students of Kondratieff we know that the autumn period builds into an orgy of speculation, which invariably leads to a stock market crash.

The two principal contributors to the 1929 Wall street crash were rising interest rates and foreign withdrawal of capital from the United States. These two factors are again making their presence known on Wall Street. If past history is anything to rely upon, then a crash of US stocks is imminent and the Kondratieff winter of deflation and depression will follow. This will usher in the age of gold.

Last Minute Notes

Space limits our last minute notes for this edition. Suffice it to say that it is probable that two rocket ships will soon pass each other at some point not far from the earth’s atmosphere. The rocket ship Stock Market on its reentry back to earth after its trip to the moon; and we hope it lands without crashing. The rocket ship Gold is on its way to the moon!

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If you can dream
- and not make
dreams your
master,
If you can think
- and not make
thoughts your
aim.
If you can meet
with Triumph
and Disaster,
And treat those
two impostors
just the same;
If you can bear
to hear the truth
you've spoken
Twisted by
knaves to make a
trap for fools,
Or watch the
things you gave
your life to
broken,
And stoop and
build 'em up
with worn out
tools.

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