Gold, How Undervalued Art Thou?

By The Mogambo Guru

09/12/05 According to the Mogambo, the next time somebody taunts you for being a gold bug, you can tell them that the International Monetary Fund (IMF) believes in gold.

From the IMF website, we read that one of their "principles" is, "As an undervalued asset held by the IMF, gold provides fundamental strength to its balance sheet. Any mobilization of IMF gold should avoid weakening its overall financial position." So, even the IMF itself says that gold is undervalued! I mean, what more do you want, for crying out loud? Buy gold!

As for their stash of the yellow metal, "The IMF holds 103.4 million ounces (3,217 metric tons) of gold at designated depositories." This is the gold that the United States and the other signatories of the deal that created the IMF literally gave them. I stare at you blankly for a few seconds, until I finally say, with a deadpan expression, "We gave them our gold?" It should sink into your head how I feel about that, and that is how you will feel about it, too, or else you will do very badly in this class.

Anyway, they go on to say, "The IMF's total gold holdings are valued on its balance sheet at SDR 5.9 billion (about $9 billion) on the basis of historical cost. As of February 28, 2005, the IMF's holdings amounted to $45 billion (at then current market prices)."

Not only that, but the IMF used gold as money, as is clearly indicated when they write that, "A payment of charges (i.e., interest on members' use of IMF credit) were normally made in gold. A member wishing to purchase the currency of another member could acquire it by selling gold to the IMF." So, you are probably asking yourself: Why didn't they just pay each other with a fiat currency? Hahahaha! They know the value of that crap, which ought to tell you something, too!

The IMF and Gold: Just Another Fiat Currency

All this was changed when, "The Second Amendment to the Articles of Agreement in April 1978, eliminated the use of gold as the common denominator of the post-World War II exchange rate system and as the basis of the value of the Special Drawing Rights (SDR)." In case you were wondering, SDRs are just another fiat currency, a new and special "let's pretend" money used only to transact IMF business, World Bank business, and God only knows what else. But they eliminated gold as the basis for their money because they knew that gold was going to get very valuable very soon, and sure enough, it did! It soon went over $850 an ounce! And remember that Nixon had de-linked the dollar from gold just seven years earlier, when gold was selling for about $35 an ounce! Anybody who had borrowed gold at $35 an ounce was going to pay it back with gold that costs $850 an ounce? Hahahaha!

Another principle that they say guides the IMF's policy on gold is that, "The IMF should continue to hold a relatively large amount of gold among its assets, not only for prudential reasons, but also to meet unforeseen contingencies." And this is exactly what I have been screeching for you to do, too! But do you listen to me? No! I feel a little better knowing that you don't listen to the IMF, either, and they have those fancy-pants offices, and I am just a lonely guy who is paid to clean the toilets and refill the snack machine. So – and here's a tip – while I don't expect the fawning deference you would have for the IMF, a little respect might help me decide which one I do first.

Anyway, as we march relentlessly forward in time, we watch as our hair first becomes grey, then thin, and we don't notice that the IMF has also been busy. But they have. During the years 1976-80, under, "Auctions and 'restitution'," we learn that, "The IMF sold approximately one third (50 million ounces) of its then-existing gold holdings following an agreement by its members to reduce the role of gold in the international monetary system." In short, the IMF started selling the gold that we gave them to get the IMF started, and did it to try to gobble up some of the mountains of money that were being created by the idiot governments, hoping to prevent a world-wide conflagration of inflation. My God! Aren't we scared enough?

So, how were they paid for the gold? Easy! "Half of this amount was sold in restitution to members at the then-official price of SDR 35 per ounce; the other half was auctioned to the market to finance the trust fund, which supported concessional lending by the IMF to low-income countries." Let me get this straight so far: We created the IMF, and we gave them a lot of gold to get started. Then, later, after IMF had screwed things up and a caused bunch of countries to become so highly indebted that they are on the edge of default and so much money was created that it was literally sloshing around, threatening to produce roaring inflation, the IMF sold the gold, to again finance a bail-out of a bunch of low-income countries (with "concessional lending") that were so stupid as to follow the bad advice of the IMF, which threatened to default on debts owed to our banks? Hahahaha!

If your heart is thumping ("boom boom boom"), and you have sharp pains shooting through your chest ("ouch!") and your left arm is numb, then you are starting to really get the hang of this economics thing. I'm proud of you!

The IMF and Gold: "Off-Market Transactions"

Anyway, abruptly we are again off to the future, and after a short ride we get off the bus at the period 1999-2000. This is where we reach the historical spot where we first find "Off-market transactions in gold." This was initiated in December 1999 when, "the executive board authorized off-market transactions in gold of up to 14 million ounces to help finance IMF participation in the Heavily Indebted Poor Countries (HIPC) initiative," which is, as always, another welfare giveaway program. And welfare programs always expand and expand until they bankrupt any country so brain-dead as to allow it to happen, which is, as it turns out, almost all of them.

The United States is included in this, I am sorry to say, as almost a third of all the people in this country are supported by the government. And it makes you wonder what in the hell an "off-market transaction" is, but I don't want to know, as I know too much already. If I really knew what in the hell was going on, I would certainly be on the evening news, with breathless on-the-scene reporters yelling, "It's The Mogambo again, Ted! He's really lost it this time!" In the background you would hear the sound of gunfire, screams of pain and torment, yelling, "The Federal Reserve has killed our money and is killing you, too! We're freaking doomed!"

Fortunately, my usual cacophony of screaming anguish and mortal torment are muffled by the thick walls of the Mogambo Top Secret Bunker In The Backyard (MTSBITBY), because when I think of the inflation that is coming our way thanks to all the money that has headed our way, I have to ask myself, as you will no doubt ask yourself, "Is the .50 caliber machinegun truly adequate to defend against neighbors rioting in the streets because inflation has impoverished them all, and now they want revenge on The Mogambo for one flimsy reason or another… mostly involving a few un-repaid loans and an unfortunate incident that was eerily similar to the Hardy Boys book, 'Mystery of the Missing Lawn Furniture and Barbeque Grills'?"

To show you how weird things are, even the Federal Reserve has started listening to The Mogambo, probably because it is hard NOT to listen to the Mogambo, because every day I am calling them up and leaving messages, such as "Hey, you big fat stupid buttheads! Inflation is roaring in stocks and bonds and houses and government! Wake up, you morons! Inflation is every freaking where, dudes!"

Anyway, whether or not they actually DID listen to me, Stephen Roach of Morgan Stanley, notes, "Belatedly, Alan Greenspan has finally paid lip service to the mounting perils of the Asset Economy. In his recent swan song at Jackson Hole, the Fed chairman cautioned that 'history has not dealt kindly' with investors (i.e., American consumers) who may have gone too far in 'accepting lower compensation for risk' on their asset holdings. Even couched in all the oblique caveats so typical of Fedspeak, this is quite a confession. The father of the asset economy now fears he has created a monster."

Well, duh! Isn't that exactly what I have been saying over and over and over for years and years? And isn't that ALL I have been saying? And isn't that why I have no friends (but plenty of new enemies), and I am now old and bitter and very, very angry? And did I mention very, very scared and paranoid? I meant to.

So if you are a holder of stocks or bonds or houses, then you should be afraid.

Regards,

The Mogambo Guru
for The Daily Reckoning

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The Mogambo Sez: A new report published by Sprott Asset Management of Toronto, entitled "Move Over, Adam Smith: The Visible Hand of Uncle Sam," concluded that the U.S. government has manipulated the stock market to keep asset prices up so many times, and for so long, that, "what apparently started as a stopgap measure may have morphed into a serious moral hazard situation, with market manipulation an endemic feature of the U.S. stock market."

That anyone doubted it is what surprises me. They have to keep the stock market up, as the financial services industry produces 40% of the profits made by the whole freaking country! Every level of government has borrowed and spent with the idea that inflation will always be around three percent, which means that their tax revenues will increase forever, and they have spent accordingly!

And, as if that wasn't dependence enough, everybody's retirement plan is also totally dependent on the stock market! My God! And you thought the government was not intervening in the market? Hahahaha! When the tragic results of the market falling by 50% would only put it in the middle of historic range of the price to earnings (P/E) statistic? Hahahaha!

Like they say, at the end of long booms brought about by the creation of excess money and credit, the amount of corruption is off the charts.