

Wealth Creation versus Labor Preservation



As of late, gold seems to be subject of many conversations. One side claims that gold is a bad investment

while the other touts it as a superior investment. Through continued research, I am led to believe that gold may be mischaracterized. Let me share with you what I was reading the other night.

Economies of the Past

In years past, humankind sustained commerce through a barter system. If you wanted chicken for dinner, you traded something of equal value for the chicken. However, if all you owned was a cow, you either found yourself with a lot of chickens or no chicken for dinner. As time went on, villagers developed various forms of currency to facilitate the trading process. To arbitrarily assign value, let's say a cow equaled 100 shillings, a chicken would equal 1 shilling, a pig – 30 shillings, a sword – 45 shillings and so forth. If I sell my cow, I now have 100 shillings to purchase a chicken, pig, and sword with a little left over for a night out at the village tavern. In order to provide validity to this currency, something precious was usually used to provide value such as gold or some other precious metal.

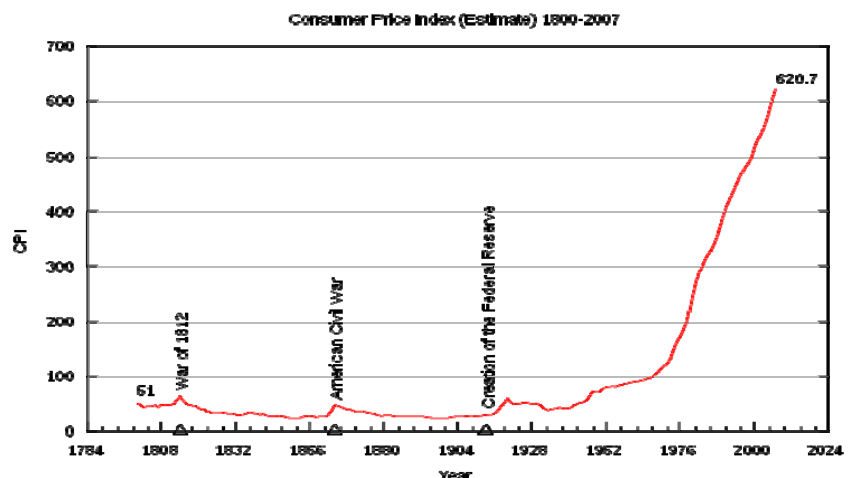
As time moved on, villages consolidated into kingdoms and received

protection from whatever leader emerged paid for through taxation. Often, the king, queen, duke, emperor, or other leader would demand that the subjects surrender their currency (gold or other precious metal) in exchange for royal currency in order to keep orderly exchanges between patrons and to protect the kingdom's gold. All was well under honest leadership.

Inflation's Debut

Inflation first emerged as some kings learned that they could expand their wealth by simply creating more royal currency. Once it was discovered that an honest parity did not exist between gold and the royal currency, the subject currency would drop in value (inflation). It suddenly occurred to me that "inflation" is just another word for theft. You see, if a king decides to issue two royal coins for one shilling, in essence, he just plundered the labor of his subjects. What one shilling could purchase in the past could now only purchase ½ the amount. Had the subject retained their gold, there would be no theft of labor hours

because gold cannot be counterfeited. The U.S. has experienced the same issue. Prior to the Bretton Woods Accord, the U.S. relied upon a gold standard for currency issuance. In other words, you could always receive a stated amount of gold for each U.S. Dollar. In 1944, the Bretton Woods Accord pegged the U.S. to the price of gold at \$35/ounce. This was done in order to stabilize world currencies due to Nazi counterfeiting. All was well until the king started issuing more royal currency. Around the time of the Korean and Vietnam wars, the U.S. started printing dollars. As the world caught on, they began to surrender dollars in exchange for gold (while gold rose to \$65/oz in U.S. dollars, gold could still be purchased from the U.S. for \$35/oz). The U.S. was rapidly depleting its gold supply for dollar redemptions. As a result, President Nixon closed the U.S. Gold Window and allowed our currency to float freely against other currencies. Prior to the Bretton Woods Accord, the U.S. rarely experienced inflation (see graph below). Since then, inflation has occurred nearly every year.



The Epiphany

Through continued reading it occurred to me that gold may not really be an investment, per se, but instead, a representation of labor. Receiving 100 shillings for a cow represents the 100 hours of labor expended to produce the cow, 30 hours for a pig, 1 hour for a chicken, and 45 hours for a sword. Granted, it is clearly not this simple. Commerce has a demand component that provides profit in excess of labor (A prized bull, rooster, sheep, or a high quality sword can provide profit in excess of *current* labor, but still, part of the profit represents a culminated effort of “stored labor” to develop the item of quality). This leads to another question: Why does the price of the cow keep moving up? Has labor become more expen-

sive? Or has the king simply printed more currency?

Testing the Theory

The chart below includes three time periods (1972, 1990, and 2007) with a list of prices on certain items to include the price of gold per ounce. Under each item lists the quantity of gold needed to purchase the item for that year.

Interesting enough, a Ford Mustang could be purchased for approximately 50 ounces of gold and a home averaged around 400 ounces. Although these findings are not scientific, gold’s purchasing power is quite intriguing. Of course there are many variables that can affect pricing. Today’s homes, cars, toys, etc. include

many more amenities than they did in 1972 (Carpeting, wood floors, appliances, furnishings, GPS, audio, leather, wheels, etc). Although today’s products have more enhancements, this was only possible through productivity increases over the decades, especially farming. A larger sampling may very well reveal some variations or maladjustments. Aberrations often occur in the marketplace and, in time, are corrected through market adjustments (The price of oil averaged around 6 ounces of gold, per 100 barrels in 1972 and 1990, then spiked in 2007 (see graph) and now is around 6 ounces of gold in 2009).

In light of this evidence, gold appears to be an efficient storage labor – your labor. However, there are periods of distortion. Gold lost its appeal in the ‘80s and created a glut in the market. Since 2000, the luster of gold has caught the attention of many and this appeal may very well have a premium attached it (much like the cost of a portable generator after a natural disaster strikes). Even with these distortions, gold is predominantly a *currency of exchange for labor*. There are many items that represent a store of labor such as tractors, steel, scotch, ammunition, art, rare books, wine, batteries, razor-blades, etc. While some have investment appeal, others represent the store of labor that commodities afford (cows, pigs, and chickens do too!).

Year	1972	1990	2007
Gold/Ounce ²	\$58.42	\$383.51	\$695.39
Average Home Price ³	\$24,700	\$150,000	\$314,000
Cost In Gold	422.8 oz	391.12 oz	452.8 oz
Ford Mustang ⁴	\$2,873	\$20,949	\$35,000
Cost In Gold	49.18 oz	54.62 oz	50.33 oz
Oil ⁵ /bl x 100	\$360	\$2,319	\$6,420
Cost In Gold	6.16 oz	6.05 oz	9.24 oz
IBM/sh x 100 shs	\$725	\$2,000	\$11,000
Cost In Gold	12.41 oz	5.22 oz	15.82 oz
S&P 500 Index	109.78	332.75	1,478.10
Cost In Gold	1.88 oz	0.87 oz	2.13 oz
Corn/Bl x 100 ⁶	\$125	\$262	\$390
Cost In Gold	2.14 oz	0.68 oz	0.56 oz
Soybean/Bl x 100 ⁶	\$340	\$512	\$775
Cost In Gold	5.82 oz	1.34 oz	1.12 oz
Lumber ⁶	\$125	\$195	\$275
Cost In Gold	2.14 oz	0.50 oz	0.40 oz



The Royal Printing Press

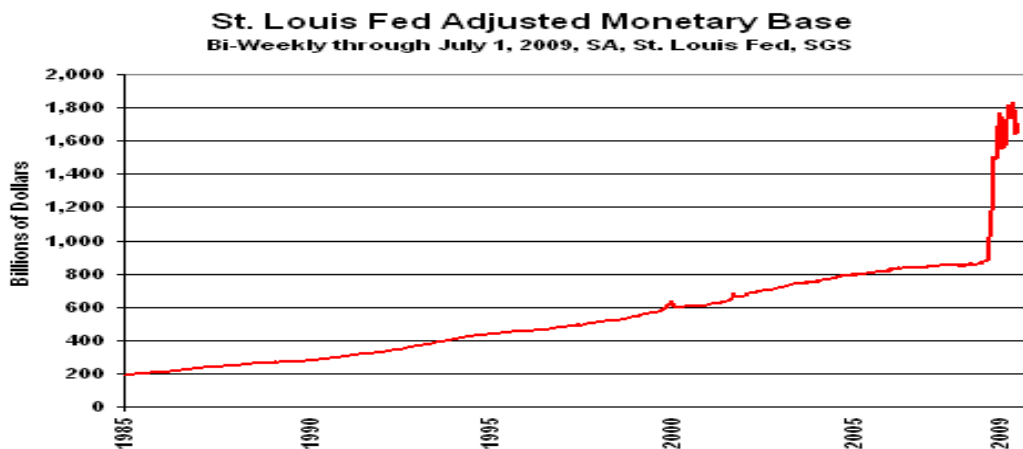
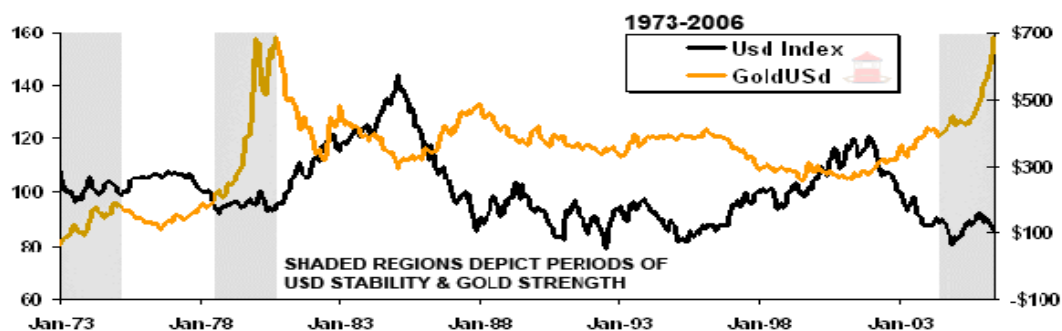
The rapid increase in the price of gold indicates that the royal printing presses are in over-drive. I have included two graphs that illustrate the relation of gold to the U.S. Dollar. The first graph depicts the inverse relationship between the U.S. Dollar Index (USD) and the Gold Index (GLD). I also included a second graph that measures the M1 supply during the same time period (M3 was discontinued in 2006). When the king prints more royal currency (Graph 2), the dollar weakens and gold strengthens. In this medium (gold), the store of labor is preserved. Finally, the last graph illustrates the M1 Adjusted Monetary Base to date. Since 2006, the M1 has increased significantly.

Conclusion

I think it is important to distinguish the differences between gold and common stocks: Gold stores value (and most commodities) while investments can pro-

duce returns in excess of stored value. Gold has never become worthless but investments have and can go to \$0. The risk inherent in stocks is the very reason why they can create wealth. As an investor, we evaluate the risk and the endeavor and decide whether the risk merits the reward. If the entity that we invest in does well, then both parties benefit. I know as of late, the feeling toward the stock market has not been favor-

able but it is important not to lose sight of why we invest. Earlier this year, I wrote the following on this subject: *For some odd reason the movie "Ten Things I Hate About You" keeps popping into my head. The movie essentially depicted a high school romance between two dissimilar students. In the end, the girl's heart was broken. As part of her school project, she penned the ten things she hated most about her ex-boyfriend and read it out*



loud in front of her class and her ex. As it turned out, the things she hated most about him are the things she really loved most about him. To me, the premise of the movie was that we can quickly hate the things we love. I think I can certainly apply that to the market place. Without question, I love the excitement the market brings. I love the research. I love the opportunity for growth. I love the diversification that is available and I love the service the waitress gave to my wife and me the last time we went out for dinner. I think it is important to keep myself on guard against turning on the things that I love.

Gold is often excoriated by Wall Street as a dead horse but my initial research begs to differ. I believe it has a place in any invest-

ment portfolio. However, it is not only gold that preserves your labor. Items that are commodity based also hold the value of your labor (inflation resistant) and should be included in the portfolio. So the next time you walk past a good bottle of scotch or wine, think about storing your labor in that bottle (I know I will and I will certainly try to run this logic past my wife the next time we walk past a tractor). However, if you want to create wealth, then stocks must be considered as a means. Since October 2007, the risk inherent with common stock has been all too honest with the investing public. Let us not forget that if the idea makes sense and there is good management, then the opportunity for profit may very well exceed the risk. In the end, all may benefit.

Source: www.chartingstocks.net/wp-content

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Source: www.inflationdata.com/inflation/inflation_rate/historical_oil_prices_table.asp

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