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Biiwii Commentary

***e*Research Corporation** is pleased to provide an article, courtesy of Biiwii.com, and written by Keith Weiner (link to the Author is provided on the following page).

The article, starting on the next page, is entitled: **"You Cannot Eat Gold!".**

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Along the way, a geek-like interest in technical analysis, a long-time interest in human psychology, and various unique macro market ratio indicators were added to the mix, with the result being a financial market newsletter (and dynamic interim updates), Notes From The Rabbit Hole (NFTRH) that combines these attributes to provide a service that is engaged and successful in all market environments by employing risk management first, and opportunity for speculation second.

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You Cannot Eat Gold!

By Keith Weiner

October 15, 2018

"You can't eat gold." The enemies of gold often unleash this little zinger, as if it dismisses the idea of owning gold and, indeed, the whole gold standard. It is a fact, you cannot eat gold. However, it dismisses nothing.

This gives us an idea. Let us tie three facts together. One, you can't eat gold. Two, gold is in backwardation in Switzerland. And, three, speculation is a bet on the price action.

The fact that gold is inedible is supposed (by the enemies of liberty) to be proof positive that a gold standard would not work. Of course, there is always the retort: You can't eat dollars!

That may be emotionally satisfying, but there is a deeper issue that the anti-gold crowd is missing. Yes, money makes terrible food but, also, food makes terrible money. A car makes a lousy airplane, and a shoe makes an awful TV. Cow poop is putrid as food for people, but it works well as fertilizer for plants. Each thing fits a particular purpose.

Why does food make terrible money? One reason is that it is perishable. No one—other than a refrigerated warehouse—can make a bid on food beyond his own short-term needs. Without this robust bid, food has limited marketability. That is, it has a wide spread between its bid and offer prices.

Think of it in human terms, or even personal terms. Suppose you are strolling along the sidewalk, and you are hungry. You see a restaurant sign, "Hamburger + fries + drink, $10." You would pay the offer price. The next restaurant is going out of business, and its sign says, "All inventory must go! 50 hamburgers and 50 pounds of fries for $100!" You would not pay it (unless you were with 49 friends).

Why not? It is because you cannot possibly carry 49 juicy hamburgers and 49 pounds of hot, greasy fries with you as you walk! The bid price is zero or nearly zero. So the bid-ask spread on food is quite wide.

Other than for eating, a hamburger serves no purpose. And you only need to eat a finite amount (unless you are Hafthor Bjornsson). Any burgers beyond that are of no value to you, because they do not keep very long. You do not want to stockpile them.

Economists would say that the marginal utility of hamburgers falls rapidly. The first hamburger satiates your hunger. The second fills you up. The third, well, maybe you were really hungry. The fourth doesn't do anything for you. It is useless.

Gold is in Backwardation in Switzerland

Now we switch to the second topic: Gold is in backwardation in Switzerland. What does that really mean in human terms? It means you can give up your 100 oz gold bar for 3 months, get free use of about CHF 120,000 in the meantime and, in the end, get your gold bar back. Plus about CHF 400 in profit.

No one is taking this deal.

Let that sink in. Lots of people have these gold bars. Which they cannot eat, as we have already proven. But they will not let them go for even three months. The free use of francs and the profit are not attractive. This either means they don't trust their counterparty to give the gold back, or else that the francs are even more useless than the gold.

Given the high price of the franc—just over $1—we don't think that the problem is trust of the counterparty. We would say (and have argued these past few weeks) that the problem is that the Swiss National Bank so flooded the market with francs that they are now useless. So useless, that people will not decarry gold for a profit. So useless that the bid to borrow them—the bid on the interest rate—is negative.

Speculative Assets Are Useless

Switching topics again, let us return to something we have often criticized: buying stocks or bitcoin with the hope that the price will rise. Why will it rise? Because the next guy will come along and bid higher. Why will he do that? Because he expects the yet-another buyer to bid even more.

And so on? No. There is an end to this cycle. Inevitably, the supply of buyers is depleted. And then what happens is silver in spring of 2011. Or stocks in 2008. Or tulips in 1637.

Why are there no more buyers? To answer, let us tie all three of these seemingly isolated facts together. People are buying something, not for any use they can make of it, but solely to front-run that next buyer. He also has no use for it, but merely buys to unload to the next buyer in the chain.

They are all buying something they cannot use, in the hopes of selling it, but no one is asking if anyone has any use for it! This is why mainstream investors do not buy gold.

We, the gold community, must change our message if we want to reach them. "Gold's going to $10,000" is not reaching them.

At best, mainstream investors think "maybe". Or else they think, "You have predicted 93 of the past 0 gold spikes to $10,000."

If the only purpose of a thing is to sell it for a higher price, then that thing has no purpose. This could almost be a corollary to Mises' Regression Theorem. Anyway, gold (unlike francs nowadays, or tulips back in the 17th century) does have a productive purpose.

We spill a lot of words talking about borrowing, lending, interest, debt, extinguishing debt, and servicing debt. We dismiss the definition of money commonly held to be the "medium of exchange" as wrong. We believe that it smothers the premise that the government can change economic law merely by enacting legislative law.

It is more important to look at whether a thing can extinguish debt than whether it trades for hamburgers. Why is money not defined in terms of purchasing power, but as the most marketable good? Why is it important to compare the hamburger, whose marginal utility falls to zero, the franc, whose marginal utility is now apparently negative, with gold whose marginal utility is a flat-line or nearly so?

Money Is Gold, Gold Is Money

The hamburger is food because it provides nutrition. Gold is money because it has the narrowest bid-ask spread of any commodity. It has the highest stocks to flows, which shows that its marginal utility declines so little—that after thousands of years of accumulation, we are still mining more. It is the most marketable commodity, because it has a use to billions of people.

That use is final payment. Even if most people, most of the time, are happy to be creditors, some people some of the time want to be finally paid. Gold, the extinguisher of debt, is final payment.

There is never any question about the value of something that has constant or nearly constant marginal utility, because it is the final payment demanded by billions of people.

Note: we are not saying payment as in exchange for goods. We are saying payment as in what a creditor demands in satisfaction of the debt. Money is a capital asset. It is not necessarily the hot potato that people receive as wages, and rapidly turn around to pay for goods.

Consider the case that China sells consumer goods to America to obtain dollars, just in time to pay Venezuela for oil. And they, in turn, pay them out in wages, machine parts, and welfare largesse. For this scenario, any old medium of exchange will do. The dollar works fine, and the parties involved would not agree if you denied it.

But money is the thing which is valued specifically to hold, and for the sake of holding it. Unlike the dollar, which can clear trade as a medium of exchange but is not good for saving—gold is good for saving.

Unlike bitcoin, which people speculate will have greater *purchasing power*. They plan merely to exchange bitcoin for a greater quantity of consumer goods tomorrow. If something is just a token held to trade for consumer goods, it is not a capital asset. It is just deferred consumption, just a deferred consumer good.

Keynes taught that consumption makes the economy go. We suppose that, to Keynes, if an asset goes up and people can sell it to consume more, this is a good thing. Anyway, Keynes was utterly wrong. This is a frivolous error. One cannot consume something that has not been produced. Production must precede consumption.

For hundreds of thousands of years, humans lived at the level of subsistence. They could only produce whatever could be done with their own hands, and at best simple hand tools. They did not accumulate capital.

Capital accumulation and investment make the economy go. Keynes misses this fact, along with all who love the (seemingly) endless rise in asset prices driven by the (pathologically) falling interest rate. They think that it is possible to consume without producing, by just betting on rising prices. They don't know that they are just eating the seed corn.

So long as one man has a surplus of hamburgers and another has a surplus of gasoline, they will want to trade. So long as men want to trade, there will be some kind of medium of exchange. But that medium of exchange is not necessarily money. That medium can convey value, but not store nor measure it.

JP Morgan said it best, in his testimony before Congress.
"Money is gold, and nothing else."

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